IN THE

Supreme Court of the United States

October Term, 1977

No. 77-564

HUNTINGTON TOWERS, LTD.
and RICHARD CAREY,

Petitioners,

against

FRANKLIN NATIONAL BANK (in liquidation) and
FEDERAL DEPOSIT INSURANCE CORPORATION,

Defendants,

FEDERAL RESERVE BANK OF NEW YORK,
EUROPEAN-AMERICAN BANK, and JAMES SMITH,
individually and as Comptroller of the Currency,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.

Opinions Below

The opinion of the Court of Appeals, not yet reported, is printed as Appendix A to this petition. The opinion of the District Court for the Eastern District of New York, not yet reported, is printed as Appendix B to this petition.

Jurisdiction

The opinion sought to be reviewed was decided and entered on July 19, 1977. The jurisdiction of the Court is invoked under 28 U.S.C. Section 1254(1).

Statutory Provisions Involved

The statutory provisions involved are the National Banking Act, 12 U.S.C. §§91, 191, 192, 194; Federal Reserve Act, 12 U.S.C. §§347 and 347(b); The Judiciary Act, 28 U.S.C. §1361; The Federal Tort Claims Act, 28 U.S.C. §2680(a) and (h). All pertinent parts of the above statutes are set forth in Appendix C to this petition.

Questions Presented

1. Does this Court have jurisdiction to determine petitioners' claim for declaratory and injunctive relief against the unlawful action of the Comptroller and the Federal Reserve Bank concerning their conduct and participation in the Franklin National Bank insolvency?

2. Can this Court impose liability upon the Comptroller when he acts in an unlawful manner (1) in failing to declare an insolvent bank insolvent, (2) in purporting to declare an insolvent bank solvent, (3) in actively keeping an insolvent bank open, (4) in consenting to an unlawful preference among creditors in violation of 12 U.S.C. §194, and (5) in failing to take action to have such claimed preferential liens declared null and void for the purpose of effecting a ratable distribution of assets of Franklin National Bank?

3. Does the Federal Reserve Bank have the power to make advances to an insolvent bank?

4. Does the Federal Reserve Bank (hereinafter "FRB") obtain a valid lien on the property of an insolvent bank when it knowingly extends credit to an insolvent bank?

5. Does federal law characterizing and authorizing a national bank to make a commercial loan that under state law would be considered a real estate mortgage loan, avoid the New York State Statute of Frauds defense?

6. Did the petitioners sufficiently part perform the agreement to finance the construction of an office building to create an exception to the New York State Statute of Frauds defense?

Statement of the Case

The Petitioners

Huntington Towers, Ltd. (hereinafter "Huntington") and its sole stockholder Richard Carey (hereinafter "Carey") were the owners and developers of a parcel of

improved commercial real estate located on Long Island, New York.

In November 1973, Franklin National Bank (hereinafter "FNB") agreed to advance such funds as were necessary to complete construction of petitioners' proposed second office building (Huntington Towers II) up to a total amount of 5 million dollars against the commitment from a responsible lending institution to issue a permanent mortgage on the completed building in addition to obtaining a major tenant for the completed building. The petitioners proceeded with the construction of this building, secured the necessary permanent mortgage commitment and a major tenant for the building. In mid-June 1974 FNB requested and obtained additional security in excess of $3,000,000 from the petitioners consisting of certain mortgages on improved and unimproved real property, including the real property described herein, to secure the monies advanced and to be advanced in the future under the construction finance agreement between the petitioners and FNB.

FNB continued to advance funds from time to time for the construction of this building until October 8, 1974, when FNB was declared insolvent by the Comptroller as hereinafter described. Thereafter, with the exception of one $100,000 advance by European-American Bank (hereinafter "EAB"), no additional funding was provided. At the time the construction of this building stopped in 1974, the steel superstructure was 80% completed. This was one of the major office building construction projects on Long Island at that time and was quite important to the real estate industry.

The Comptroller

From July 1973 until 1976, the Comptroller was James E. Smith. FNB was a national bank supervised by the Comptroller. As of December 31, 1973, FNB was the 20th largest bank in the United States with total resources of $5 billion, total deposits of $3.7 billion and total loans of $2.4 billion. FNB had 104 offices, for the most part, located on Long Island, New York.

Beginning in 1969 FNB began to develop serious problems or extraordinary deficiencies in its operations which continued virtually unabated until it was declared insolvent. As of the Comptroller's examination of November 14, 1973, total resources had grown to $4.9 billion or 29% greater than shown by the prior examination of the bank on November 8, 1972. However, the capital of FNB had increased less than one half of one percent and demand and savings deposits had declined by 5.5%. FNB's growth had been financed almost entirely by the use of short term funds, including money market certificates of deposits and time deposits of other banks, totaling $2.3 billion or 50% of FNB's liabilities. These deposits were highly volatile and the Comptroller knew that they would likely be withdrawn from the bank rapidly in the event there was any reason to question the soundness and stability of FNB.

The November 14, 1973, bank examination showed uncollectable loans totaling $10 million and loans whose credit quality was criticized, although the loans were not necessarily deemed uncollectable, of $275 million. The amount of the criticized loans equaled 162 percent of the bank's equity capital of $170 million. The bank also had outstand-

ing $3.8 billion in contracts to buy or sell foreign currency at a future date, a volume which far exceeded the bank's normal needs and showed heavy speculation in foreign currency. Moreover, the bank's operating income was poor. It was apparent that the bank's poor earnings, potential loan losses, or extended foreign exchange position might easily cause a loss of confidence in the bank, which in turn would result in a serious and overwhelming liquidity crisis. Such a liquidity crisis occurred on or before the week beginning May 13, 1974, as more fully described hereinafter.

The Federal Reserve Bank of New York

The Franklin National Bank Insolvency

During the week of May 6, 1974, the officers of FNB, the Comptroller, the FDIC, and FRB learned that FNB had suffered severe losses whose exact amount had not been determined. These losses occurred in FNB's foreign exchange department. FNB's parent corporation decided to announce these losses and it became apparent that such an announcement would dry up the bank's sources of borrowed funds resulting in a severe liquidity crisis. In anticipation of this liquidity crisis, FNB sought approval for an immediate and massive loan from FRB.

Meanwhile, during the weekend of May 10, 1974, the Comptroller spoke to John McGillicuddy, president of Manufacturers Hanover Trust Company, concerning an immediate merger of it with FNB. At that time the Comptroller advised McGillicuddy that pursuant to his powers under 12 U.S.C. §181 to waive shareholder approval and under the

Comptroller's powers to establish a conservator, the Comptroller might consider an immediate merger transaction.

The FDIC was informed on Thursday evening, May 9, 1974, by the Comptroller's office that public announcements to be made the next day (May 10, 1974) by FNB's parent corporation might well precipitate a crisis of confidence in the bank. The announcement to be made on May 10, 1974, included the statement that (a) there would be a passing of regular quarterly dividends, and (b) the bank had a sizable foreign exchange loss of an undetermined amount. The Comptroller expressed a fear that there might be a run on the deposits of the bank.

On Sunday, May 12, 1974, FNB's parent corporation announced: (1) a substantial foreign exchange loss due to unauthorized trading, (2) a plan to raise $50 million in new capital through a right's offering and (3) the likelihood of significant management changes on Monday. In a special news release, issued simultaneously, the Vice Chairman of the Federal Reserve Board of Governors announced that the Federal Reserve System, having been assured of the solvency of FNB by the Comptroller, stood ready to advance FNB the liquidity funds it needed within the lmits of the collateral that can be supplied. On Monday, May 13, 1974, at the request of the bank's management, the SEC suspended trading of Franklin's securities, 39 F.R. 18166 (1974). On Monday, May 13, 1974, FNB's parent corporation announced the firing of FNB's president and chief administrative officer and the resignation of its chief international executive. By Wednesday, May 15, 1974, FNB's loan at the FRB discount window had reached $780 million. Within 10 days of May 12, 1974, FRB was re-

quired to advance $1.125 billion to enable FNB to meet its present obligations. By the end of May, FNB's advance to FRB had climbed to $1.2 billion. Thereafter, the FRB continuously advanced money to FNB to give it the appearance of solvency to meet its present obligations until the Comptroller finally acted on October 8, 1974. By the time FNB was declared insolvent, the FRB had advanced $1.7 billion into FNB in exchange for collateral to secure the loan in an amount close to $2.3 billion.*

The FDIC was kept informed on a current basis of all developments within FNB and had a group of FDIC examiners, along with a task force of the Comptroller's examiners, monitoring daily changes in the bank's condition. The FRB bank examiners reviewed the collateral being provided by FNB for its steadily increasing loan. During mid-June at FNB's request, petitioners gave FNB approximately $3 million additional security consisting principally of mortgages on petitioners' property.

By early June, the task force of Comptroller and FDIC examiners, on a crash basis, put together information for the prospective sale of FNB. The FDIC also developed contingency plans, at the initiation of the Comptroller and the Federal Reserve Board, for an FDIC assisted purchase and assumption transaction.** T he FDIC assisted transaction would have at least three components, including (1) an FDIC indemnity against FNB liabilities not specifically assumed by the purchasing bank; (2) a throwback provision

* The FRB claimed the loan value of this collateral to be $1,854.4 million.

** Such an arrangement is only possible where a bank is insolvent, 12 U.S.C. §191.

whereby the purchasing bank would return to FDIC undesirable loans and securities; and (3) an FDIC purchase of a capital note issued by the purchasing bank.

On July 2, the Comptroller informed the FDIC that an FDIC assisted sale of all or part of FNB's assets and the assumption of its deposit liabilities was in order. The Comptroller requested the FDIC (as the Federal Reserve System had several weeks earlier requested) that the FDIC initiate discussions with banks to explore the possibility of consummating such an FDIC assisted transaction.

By Saturday, October 5, 1974, the FDIC informed the Chairman of the Federal Reserve Board and the Comptroller that an arrangement had been made whereby at least two of four prosective purchasing banks would bid on a proposal prepared by the FDIC for the sale of FNB, and that all of the regulatory agencies were prepared to proceed if FNB were declared insolvent. The Comptroller then acted to declare FNB insolvent.

On October 8, 1974, the Comptroller became satisfied that FNB was insolvent and unable to meet the demands of its depositors and unable to pay its just and legal debts. The Comptroller stated that he is not required to wait until the losses he finds in the bank's assets are actually charged against the bank's book equity capital. It is the Comptroller's duty to determine when a bank has reached the point when it will not be able to meet the obligations to its depositors in the near future.

The FDIC Board of Directors (Frank Wille, James Smith and George LeMaistre) convened on October 8, 1974, in the Federal Reserve Bank of New York to accept the bid

of EAB to become the purchasing and assuming bank of certain of FNB's deposits and liabilities. Such action was taken by the FDIC under the Bank Merger Act and the National Bank Act. An *ex parte* hearing before Judge Judd was held and thereafter, the Court approved the purchase and assumption agreement and all related transactions.*

The FDIC, contrary to its practice in all recent bank failures that resulted in an immediate purchase and assumption transaction, decided that it would not, under any circumstances, pay off the FRB loan to FNB in full on the day FNB was declared insolvent. The FDIC acknowledged that a purchase and assumption transaction could have been consummated in May, 1974 but only at some risk to its trust fund. The FDIC believed that the trust fund that it administers was substantially protected by the five-month delay by the Comptroller in declaring FNB insolvent. During that period of time, the FDIC was permitted to structure a deal that would minimize impact upon it and the FRB, although the general creditors, bondholders and shareholders would suffer some loss.

The FDIC, as received of a national bank, recognized its fiduciary duty to the creditors of the bank and its shareholders to realize the highest price for the going concern value of FNB. The FDIC also recognized it has a statutory duty to minimize its own loss. The FDIC clearly knew that the only basis for the continued existence of FNB was the continuous loan to FNB by FRB, for once the eligible collateral of FNB was exhausted, no further loans could be made by it to FRB.

* In re, Franklin National Bank, 381 F. Supp. 1390 (J. Judd 1974).

The European-American Bank (EAB)

The Acquisition of FNB Assets

On October 8, 1974, the Comptroller, acting pursuant to the National Bank Act, 12 U.S.C. §191, certified that FNB was insolvent and appointed the Federal Deposit Insurance Corporation (herein "FDIC") as receiver of FNB as required by the Federal Deposit Insurance Act, 12 U.S.C. §1821(c). Pursuant to the authority given by 12 U.S.C. §192 and 12 U.S.C. §1823(e), the FDIC, as receiver, entered into a Purchase and Assumption Agreement with EAB pursuant to which EAB (1) assumed all of FNB's deposit liabilities and other unsubordinated balance sheet liabilities except FNB's $1.7 billion indebtedness to the FRB, and (2) EAB shall select assets of FNB in an amount equal to the amount of the liabilities assumed less the $125 million purchase premium paid by EAB on October 8, 1974, for the purchase of FNB's banking business. Most (but not all) of FNB's assets were held in an asset pool in which the FDIC and EAB had an undivided interest. Some FNB assets were sold to EAB immediately under Section 3.2 of the Agreement. Other FNB assets were retained by the receiver but available for purchase by EAB under Section 4 of the Agreement. During a 180-day period commencing on October 8, 1975, EAB must select those FNB assets that it will acquire. EAB must indicate those FNB assets it does not desire and such assets shall be transferred ultimately to the FDIC in its corporate capacity.

In order to facilitate the Purchase and Assumption Agreement by EAB, the FDIC, in its corporate capacity and not as received, entered into agreements providing

that, in such capacity, it will (1) indemnify EAB against unknown losses arising from past actions of FNB; (2) purchase from EAB a 10-year subordinate capital note in the principal amount of $100 million and (3) assume the $1.7 billion indebtedness owed by FNB to FRB with an agreement to reduce that indebtedness as FNB's assets, held by the FDIC, are liquidated with a repayment of such indebtedness to be completed in any event (whether or not sufficient assets have been liquidated) by the end of three years. The FDIC will function as a liquidator with respect to FNB's loans which it acquires, and in such capacity, will be interested in obtaining repayment of such loans and not in granting credit. Amounts received in connection with liquidation of FNB's assets will be used to repay the FDIC indebtedness to FRB and to reimburse the FDIC for its liquidation expenses. Any surplus amounts collected by the FDIC in the course of liquidating FNB's assets will be applied to the satisfaction of claims against the receivership estate and payment in full to subordinate capital debenture holders. All payments by the FDIC other than out of the proceeds of liquidation out of FNB's assets will be paid out of the FDIC permanent insurance fund established under 12 U.S.C. §1821 and paid for by member banks.

The Transaction Between EAB and Petitioners

On October 4, 1974, four days prior to the Comptroller's declaration of insolvency, George Rilke, then vice president of FNB and the officer in charge of the petitioners' account at FNB, authorized the issuance by petitioners of a $100,000 check payable to Ikenson Iron Works, Inc., a steel subcontractor on the second office building. The Ikensen check

was not presented for collection until on or after October 8, 1974, at which time EAB dishonored the FNB check.

Seymour Ikenson, an officer of Ikenson Iron Works, Inc., called George Hill, chief liquidator of the FDIC, to complain about EAB's refusal to honor a check drawn on petitioners' FNB account for $100,000. In addition, Mr. Ikenson had a similar check for $80,000 which had not been deposited for collection. After being advised of the situation, Mr. Hill directed Mr. Ikenson to call Mr. Klaus Jacobs, Vice President of EAB (later President of EAB). Mr. Ikenson called Mr. Jacobs and explained the situation to him. Shortly thereafter, Mr. Ikenson received a call from EAB requesting that the petitioner, Carey, and Mr. Ikenson appear at 9:30 a.m. on Friday, October 18, 1974, at the main office of EAB. At the appointed hour, Ikenson, Carey, Rilke, Vice-President of EAB (formerly Vice-President of FNB) and Jacobs met in Rilke's office at EAB. The dishonored FNB check was returned to Carey by Ikensen. Carey then signed a $100,000 note payable to EAB. Then Mr. Ikenson was presented with an EAB check payable to his company in the amount of $100,000. Ikenson endorsed the check and deposited it to his company's account. At that meeting Mr. Jacobs stated that EAB intended to finance the construction of the Huntington Towers job because EAB has a commitment to Long Island and that nothing will change on the construction of this job. Rilke advised Ikenson that the $80,000 check would be honored the following week. Both Ikenson and Carey understood from their meeting with Mr. Jacobs that EAB had agreed to complete the financing of the construction of Huntington Towers II and that the $100,000 check repre-

sented part payment for the continued and further construction of this building. Ikenson continued the steel erection on the construction site.

Mr. Rilke admitted that as officer in charge of petitioners' account at FNB, he was familiar with the timetable for construction of petitioners' real estate project for which the petitioners sought continued financing in October, 1974. However, he denies assurances that financing of this construction job would continue. Further, he denies the existence of any writing in any form in the files of EAB evidencing any agreement by EAB to provide continuing financing to the petitioners.

Contrasting this latter statement is a document on FNB stationery that acknowledges an understanding to fund the construction of this building by two former officers of FNB who, at the time of the writing, were officers of EAB. Mr. Stevenson was then Vice-President in charge of real estate operations for EAB and he specifically consented and agreed to the continued financing of the very project which is the subject of this lawsuit. Both officers were presumably acting in behalf of EAB at the time they signed this document as FNB had ceased to exist. This document was prepared shortly before the additional $100,000 advance on October 18, 1974, to Ikenson by Jacobs of EAB, that was the basis of further and additional reliance by the petitioners in continuing the construction of this building. Petitioners would not have given additional security in June of 1974 had they been aware that FNB was then insolvent and would not be able to complete the financing of the construction of the building. When the petitioners provided in excess of $3 million additional security in mid-June 1974

to FNB, they substantially and materially impaired their ability to secure financing from other sources to complete the construction of this project.

The District Court's Decision

The district court treated the FRB motion to dismiss as a motion for summary judgment and accordingly granted FRB the relief requested upon "the view the court takes of the law." The court described the first claim as one based on tort for misrepresentation and deceit in failing to disclose the alleged known insolvency of FNB. The court ruled that FRB was a federal agency and entitled to the defenses afforded under the Federal Tort Claims Act 28 U.S.C. §2680(a) and (h). The second claim of petitioners based upon a fraudulent transfer of assets of the insolvent FNB to prefer certain creditors over others was disposed of by a determination that FRB was not a necessary party. The court's rationale rests upon the theory that FRB had released its lien on FNB's assets to FDIC in return for FDIC's promise to repay the FRB. Since the FDIC was a party defendant, the petitioners should pursue any remedies with the FDIC. The court suggested unconvincingly that 12 U.S.C. §91 and §347(b) must be read in relation to each other to permit the creation of preferences in favor of FRB as a creditor of FNB. Since FRB is impowered to make loans to member banks presumably there can be no conflict of interest or applicability of 12 U.S.C. §91 to such financial transactions with insolvent banks. Of course, the court found that FNB was solvent because the Deputy Controller said it was so. Thus a "catch 22" that was created by the banking authorities was institutionalized by the district court.

The district court dismissed the "tort claim" against the Comptroller pursuant to 28 U.S.C. §2680(a) and (h) and on an unreported decision, *San Luis Rey Downs, Inc.* v. *Smith* (S.D. Calif. 75-0094, Order entered August 29, 1975). This order upon which the district court relied was entered on consent and without opposition. The court rejected the petitioners' argument that the Comptroller must be guided by some minimal objective standard of insolvency. The court found the Comptroller should not be hampered in his exercise of discretion and finally concluded that the issues raised are not justiciable. The district court never considered or ruled upon the declaratory or injunctive relief requested in the complaint.

The district court dismissed the complaint against EAB with a determination that the petitioners' part performance was not sufficient to permit the breach of agreement claim under the first cause of action. The second claim, based upon a fraudulent transfer in preference of some FNB creditors (including EAB) was dismissed because EAB was a bona fide purchaser and on the further ground that the FDIC agreed to indemnify EAB against claims of creditors or customers of FNB and because the FDIC is solvent. Therefore, the court concluded that EAB was not a necessary party to this action.

The Second Circuit's Decision

The Second Circuit quickly recognized that FRB was not entitled to the benefit of 28 U.S.C. §2680(a) and (h) and therefore affirmed the district court's dismissal of the first claim (fraudulent concealment of the insolvency of FNB) upon the theory that such a claim was not justiciable, *i.e.* the court lacked subject matter jurisdiction. The Second Circuit admitted there were "few precedents" but, nonetheless, based upon its reading of the law, it held the administrative discretion on the issue of insolvency was absolute in either the Comptroller or alternatively in the FRB. The Second Circuit disposed of the second claim (fraudulent transfer of assets) upon the basis that FRB is not a necessary party and, "the proper party affected would be the FDIC." No support is cited for this result.

The Second Circuit affirmed the dismissal of both claims against the Comptroller upon the basis of 28 U.S.C. §2680 (a) holding, in effect, that the Comptroller's decisions concerning insolvent banks are not subject to judicial review. No discussion or analysis was made concerning petitioners' claims for declaratory and injunctive relief. The court ignored the claim of illegal and improper conduct on the part of the Comptroller and FRB.

The Second Circuit affirmed the dismissal of the first claim against EAB based upon the same considerations that led the district court to dismiss based upon the N.Y. Statute of Frauds, N.Y.G.O.L. §5-703(4). However, the court reversed the district court on the dismissal of the second (preferential transfer) claim based in part upon a determination that EAB cannot at this point claim a bona fide purchaser status to avoid a trial of the issues that have been raised.

Reasons for Granting the Writ

I. The decision below conflicts with the Second Circuit's holding in *Economou v. United States Department of Agriculture, certiorari granted,* and with other decisions.

The Second Circuit in dismissing the petitioners' claims against the Comptroller, FRB, and EAB virtually assures the bank regulators that their actions are not subject to judicial review or potential liability. This startling result appears to be true whether or not the regulators act unlawfully in the performance of their duties. The Second Circuit decision relies upon the concept of public policy and that such review is nonjusticiable by reason of the absolute discretion and immunity of the bank regulators. This decision does not comport with applicable existing law governing the subject of failed national banks and it emasculates the intent of Congress to provide for a ratable distribution of the assets of the failed bank among creditors.

The Second Circuit's opinion entirely avoids discussion, analysis and decision of the issues concerning the petitioner's demand for equitable, declaratory and injunctive relief. Additionally, the court is compelled to make a sharp distinction between its action in this case and the action it took to the contrary in *Economou* v. *United States Department of Agriculture (Butz),* 535 F2d 688 (2d Cir. 1976), *cert. granted,* —— U.S. —— (1977). In the *Economou* case, the Second Circuit carefully distinguished a number of Supreme Court decisions concerning official imunity of government officials. The Court specifically held at page 696 that:

> "When it comes to suits against officials of the executive branch of the government, however, there does not appear to be any such obvious need for absolute immunity as distinguished from a qualified immunity, to insure performance of their essential government functions * * * for these reasons the trend as reflected in *Scheuer* v. *Rhodes,* 416 U.S. 232, 94 S.Ct. 1683, 40 L.Ed. 2d 90 (1974) and *Wood* v. *Strickland,* 420 U.S. 308, 95 S.Ct. 992, 43 L.Ed. 2d 214 (1975) has been toward the view that a qualified rather than absolute immunity is sufficient to insure the functioning of the executive branch and at the same time to protect the public against abuse of official power."

The Supreme Court has accepted this case for review with argument likely to be held in late 1977. The Second Circuit distinguishes the *Economou* case on the broad generalization that the breadth and character of the discretion exercised by the Comptroller under 12 U.S.C. §191 in declaring himself satisfied as to a bank's insolvency makes a clear case requiring the granting of an absolute immunity to the official. Regrettably, the Court cannot assert any authority for the position that there should be an absolute immunity extended to the Comptroller when he acts unlawfully in the performance of his duties. This is particularly true when the Comptroller attempts to hold open the doors of an insolvent privately owned bank when he knows that customers of that bank, be they lenders or borrowers, will rely upon the appearance of solvency and conduct their private financial affairs accordingly. As a result of the decision herein, the Second Circuit now has two decisions that are in conflict with one another concerning the subject of governmental immunity of executive officials.

The Second Circuit's decision would seem to conflict with the Eighth Circuit case of *Hirning* v. *Federal Reserve Bank of Minnesota,* 52 Fed. 2d 382 (8th Cr. 1931). There the Eighth Circuit held that the reserve bank could be liable under 12 U.S.C. 91 because in collecting checks from an insolvent national bank for its member banks, it brought about a preference although it did not benefit and was not itself a creditor. Also, in *Vann* v. *Federal Reserve Bank of Richmond,* 47 F.2d 786 (E.D. Va., 1929) the court held the reserve bank liable for its participation as an agent in the collection of certain checks from an insolvent national bank with knowledge of that bank's insolvency. The transaction was declared void under 12 U.S.C. §91. *Roberts* v. *Hill,* 24 F. 571 (Cir. Ct. Vt. 1885); *Texas & Pacific Railway Co.* v. *Pottoroff,* 291 U.S. 245 (J. Brandeis, 1934).

The Second Circuit's decision incorrectly interprets Regulation A §201.2(e) and 201.3(a) and (b) as permitting FRB to lend money to banks suffering from a liquidity crisis. There is no authority for the proposition that FRB can lend money to an insolvent bank, Regulation A notwithstanding. In fact, the only regulator that can lend money to an insolvent bank is the FDIC, under the Federal Deposit Insurance Act. 12 C.F.R. §201.2(g) makes it clear that the Federal Reserve credit is not a substitute for capital and ordinarily is not available for extended periods. §201.2(h) states that credit extended must comply with applicable requirements of law.

The Court should take note that if the acts complained of by the petitioners herein were accomplished by persons other than the bank regulators, then under New York com-

mon and statutory law, a fraud would have been committed, *Cassidy* v. *Uhlman,* 27 App. Div. 80, 50 N.Y.S. 318, *reversed on other grounds,* 163 N.Y. 380, 57 N.E. 620 (1898).

II. The decision below defeats long-standing Congressional policy calling for ratable distributions among creditors of insolvent banks and the decision is contrary to the reasonable expectations of citizens who utilize banks for their financial affairs.

It is common knowledge that there have been a number of bank failures in the past four or five years in the United States in which the regulators have had to take a serious and material role in arranging for a purchase and assumption agreement or other accommodation to ameliorate the effects of the collapse of a bank. There have been very few upper court modern decisions concerning the powers of the Comproller and other bank regulators to function in conformance with societal needs in the modern banking world. This Court should review the actions of the regulators in the Franklin National Bank failure (the largest bank failure in the history of the United States) to ascertain whether or not the actions that have been taken are not merely justifiable, but are also lawful, so that there will be no doubt that if such actions are not proper, then remedial steps can be taken in the form of new legislation or the regulators themselves may conduct such insolvency proceedings in a manner that would comport with the court's interpretation of the law. The Second Circuit took the position that the bank regulators are not subject to judicial supervision or accountability and accordingly the petitioners herein, and others similarly situated, are left with remedies that at least in the eyes of the petitioners,

are not adequate to assure a recovery in the event the petitioners' claims are ultimately successful.* It should be pointed out that the Commerce, Consumer and Monetary Affairs Subcommittee of the Committee on Government Operations, 94th Congress, 2d Sess., prepared H.R. Report 94-1669 entitled Adequacies of the Office of the Comptroller of the Currency's, Supervision of Franklin National Bank. That report by the Congress demonstrates a significant discrepancy on the part of the Comptroller in the supervision and liquidation of FNB. Some of the testimony in that investigation is simply astonishing especially those portions dealing with FRB's involvement with FNB officials to create a paper charade to permit the massive loan of 1.7 billion dollars by FRB to FNB. The bulk of this loan occurred within weeks after the identifiable period when FNB became insolvent in May, 1974.

The petitioners claim that the Comptroller acted in an unlawful manner (1) in failing to declare an insolvent bank insolvent; (2) in proporting to declare an insolvent bank solvent; (3) in actively keeping an insolvent bank open; (4) in consenting to an unlawful preference among creditors in violation of 12 U.S.C. §194; and (5) in failing to take action to have such claimed preferential liens declared null and void for the purpose of effecting a ratable distribution of assets of FNB. The petitioners claim that the comtroller acted arbitrarily, capriciously, unreasonably and unlawfully in the application of the law to the matters before him and that his exercise of power constituted an abuse. The right to sue a government officer for specific

* The Carey story was described and commented upon in a long article in Barron's entitled "Picking Up the Pieces" written by Steven Andreder, News Editor.

relief and the requirement that a government officer must abide by the rule of law was firmly established by *Marbury* v. *Madison,* 5 U.S. (1 Cr.) 138 (1803). A government employee is liable for his wrongful acts even though the master is immune from suit. *Osborn* v. *Bank of United States,* 22 U.S. (9 Wh.) 738 (1824). Furthermore, under 28 U.S.C. 1361, the District Courts have jurisdiction to compel an officer of the United States to perform a duty owed to the petitioners. The Second Circuit has decided that at least in so far as the comptroller's handling of the FNB matter is concerned, for reasons of public policy, the alleged unlawful conduct is not justiciable or for that matter, reviewable by the court. This is contrary to the intent of Congress. The Congress specifically required the Comptroller in 12 U.S.C. 194 to make a ratable dividend of the money paid over to him by the receiver on all claims. The facts in this case demonstrate that FRB will be paid in total the 1.7 billion dollars advanced to the insolvent FNB during the spring and summer of 1974. It is questioable whether or not any payments will be made to any of the creditors. Under the existing plan for winding up FNB, FRB must be paid before all other creditors. This clearly is not a ratable dividend as required by the Congress. A ratable distribution requires that the creditors be paid proportionately. The court is required to determine the meaning of ratable distribution in each case. The Second Circuit decision now creates in FRB a preference not found in the law and not granted by the Congress.

Conclusion

For the foregoing reasons, petitioners request that their petition for a writ of certiorari be granted.

Respectfully submitted,

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Dated: October 14, 1977
New York, New York

Appendices

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 521—September Term, 1976.

(Argued February 17, 1977 Decided July 19, 1977.)

Docket No. 76-6109

HUNTINGTON TOWERS, LTD. and RICHARD CAREY,

Plaintiffs-Appellants,

v.

FRANKLIN NATIONAL BANK (in liquidation) and FEDERAL DEPOSIT INSURANCE CORPORATION,

Defendants,

FEDERAL RESERVE BANK OF NEW YORK, EUROPEAN-AMERICAN BANK, and JAMES SMITH, individually and as Comptroller of the Currency,

Defendants-Appellees.

Before:

ANDERSON and TIMBERS, *Circuit Judges,* and KNAPP, *District Judge.**

Appeal by plaintiffs from an order of the United States District Court for the Eastern District of New York, Orrin G. Judd, *Judge,* dismissing the plaintiffs' complaint as against the defendants-appellees Federal Reserve Bank of

* Of the Southern District of New York, sitting by designation.

New York, European-American Bank and James E. Smith, individually and as Comptroller of the Currency.

Affirmed in part and reversed in part.

Donald E. Sheil, Esq., New York, N. Y., *for Plaintiffs-Appellants.*

William E. Hegarty, Esq., New York, N. Y. (Cahill Gordon & Reindel, Allen S. Joslyn, Esq., and Michael P. Tierney, Esq., New York, N. Y., on the brief), *for Defendant-Appellee Federal Reserve Bank of New York.*

Philip K. Howard, Esq., New York, N. Y. (Sullivan & Cromwell and John L. Warden, Esq., New York, N. Y., on the brief), *for Defendant-Appellee European-American Bank & Trust Company.*

J. Christopher Jensen, Esq. (David G. Trager, U. S. Attorney, Eastern District of New York, Bernard J. Fried, and Lewis F. Tesser, Assistant U. S. Attorneys, Eastern District of New York, on the brief), *for Defendant-Appellee James Smith.*

(Barrett Smith Schapiro & Simon, Michael O. Finkelstein, Esq., and Lawrence J. Zweifach, Esq., New York, N. Y., on the brief of Sol Neil Corbin, Trustee in Bankruptcy of Franklin New York Corporation, as *Amicus Curiae.*)

Anderson, *Circuit Judge:*

This is an appeal by Huntington Towers, Ltd. and Richard Carey from an order of the United States District

Court, Eastern District of New York, dismissing a complaint for monetary and equitable relief against the Federal Reserve Bank of New York (FRB), and James E. Smith, individually and in his former capacity as Comptroller of the Currency (the Comptroller), as well as against European-American Bank (EAB). The complaint had also alleged claims against Franklin National Bank (in liquidation) (FNB) and the Federal Deposit Insurance Corp. (FDIC). The district court's disposition of these last claims, however, are not before us inasmuch as the appeals of both FNB and FDIC have been withdrawn without prejudice. We affirm the order as it relates to the Federal Reserve Bank and to James E. Smith, individually and in his former capacity as Comptroller of the Currency, and affirm it in part and reverse it in part as it relates to European-American Bank.

This action resulting from the largest bank failure in United States history, the financial collapse of Franklin National Bank, which was declared insolvent by the Comptroller of the Currency on October 8, 1974, pursuant to his authority under 12 U.S.C. §191. It had been in serious trouble sometime before October 8th: large scale foreign exchange speculations, in addition to extensive loans, the collectibility of which was in doubt, had precipitated a liquidity crisis and drawn the active attention of federal regulatory officials. The Comptroller, aware of FNB's problems, had endorsed efforts in the spring of 1974 to merge FNB with a healthier institution in order to avoid insolvency. The Federal Reserve Bank of New York provided over $1.7 billion in emergency credit during this critical period, which enabled FNB to maintain banking operations. *See generally*, H. Rep. No. 94-1669 (*Adequacy of the Office of the Comptroller of the Currency's Supervision of Franklin National Bank*), 94th Cong., 2d Sess. (1976). While the Comptroller was unsuccessful in his

merger efforts, he was able to invite bids from at least four qualified banking institutions for the sale of part of the assets of FNB. The Comptroller declared FNB insolvent and appointed FDIC as receiver simultaneously. An agreement between European-American Bank, the buyer of a sizeable portion of FNB's assets, and FDIC, as the appointed Receiver of FNB, was entered into at 3 P.M. on October 8, 1974. The Purchase and Assumption Agreement was approved *ex parte* in the Eastern District of New York on the same date, *In re Franklin National Bank,* 381 F. Supp. 1390 (E.D.N.Y. 1974).

In the midst of this feverish activity, plaintiff Huntington Towers, a New York corporation owned by the individual plaintiff Richard Carey, was an FBN borrower. In 1973, Huntington was the owner and developer of a tract of real estate near New York's Long Island Expressway, on which one office building had been erected and another was soon to be constructed. The financing for the second office building was arranged with FNB in November of 1973. FNB committed itself to loan up to five million dollars on the conditions that a responsible lending institution would take a permanent mortgage on the completed building, and that Huntington and Carey would obtain a major tenant for the building. FNB continued to advance funds for the construction of "Huntington Towers II" until October 8, 1974, when FNB was declared insolvent by the Comptroller and the FDIC was appointed Receiver. Thereafter, no additional funding was extended to Huntington, with the exception of a $100,000 advance by EAB after its acquisition of a large part of the assets of FNB. Consequently further construction of the building ceased. Huntington thereafter could not secure financing from other sources, and it defaulted on a number of secured obligations. It was also faced with foreclosures on other properties which it owned. This action followed.

Huntington and Carey's complaint alleged first that, beginning on and after May 15, 1974 (approximately five months before the Comptroller's official announcement of October 8), the Comptroller, FRB and FDIC knew of FNB's insolvency and entered into an "illegal and improper" plan to conceal it. While this plan to "cover up" was ongoing, Huntington and Carey allegedly gave FNB additional security, said to have a value in excess of $3,000,000, for monies advanced and to be advanced under FNB's loan commitment to the plaintiffs. Once FNB was declared insolvent by the Comptroller, plaintiffs charged that they were assured of continued financing by EAB, FNB and FDIC, which was not forthcoming except for the $100,000 advance by EAB. These events allegedly resulted in damage to the plaintiffs of $8,000,000.

Plaintiffs' second cause of action stemmed from the October 8, 1974 Purchase and Assumption Agreement between FDIC, as Receiver, and EAB which provided that FDIC would sell to EAB certain FNB assets to be selected by EAB and to be paid for by an amount equal to FNB's deposit liabilities at the time of the receivership, minus the amount of a premium to be paid by EAB. The remaining assets of FNB would be retained by FDIC, as Receiver, and applied first, to meet FNB's outstanding obligations to FRB for the emergency credit advanced prior to insolvency, and second, to the stockholders of FNB. *In re Franklin National Bank, supra,* 381 F. Supp. at 1391-92. The provisions of the sale agreement were approved by the United States District Judge, as noted above, in an *ex parte* judicial proceeding which thereby enabled FNB to open its doors for business under its new owner, EAB, on the day following the insolvency. Plaintiffs in the instant action challenged the provisions of the sale as "contrary to law and . . . a fraud on the general creditors of Franklin National, and in particular, a fraud on innocent

persons dealing with Franklin National after it became insolvent and while its insolvency was being concealed by the defendants." Plaintiffs' status as claimants was said to derive from the retention by FNB of the $3,000,000 in collateral, which secured FNB advances to Huntington.

In taking up the FRB's motion to dismiss, the district court treated the motion as one for summary judgment under F.R.Civ. Pro. 56 "[i]n the light of documentation on other motions concerning the facts leading up to the receivership of Franklin." That documentation included a letter, dated May 10, 1974, from the Acting Comptroller to the FRB asserting that at the time of the Comptroller's examination of FNB on March 8, 1974, the Bank was found to have "severe credit and liquidity problems, but was adjudged to be solvent." On May 12, 1974, the FRB issued a press release announcing its willingness to extend credit to FNB on the basis of "a large amount of acceptable collateral available to support advances . . ., if they are needed." FRB then advanced more than one billion dollars to FNB on demand notes. Characterizing plaintiffs' first cause of action as "based on tort liability for failure to disclose the alleged known insolvency of Franklin," the district court ruled that such a claim was barred under the Federal Tort Claims Act, 28 U.S.C. §2680(h).

As to plaintiffs' second cause of action, arising out of the October 8, 1974 Purchase and Assumption Agreement disposing of FNB's assets, the court ruled that it was "not appropriate to press the claim against FRB," inasmuch as under the agreement, FRB had released its lien to EAB with respect to FNB assets purchased by EAB, and to FDIC, as a corporation, with respect to the remaining assets. FDIC had, in turn, assumed and agreed to pay the entire FRB indebtedness with interest. As a result of these transactions, the court found that FRB was not a necessary party to the litigation. Further, plaintiffs' re-

liance on 12 U.S.C. §91, which renders void certain transfers of the assets of a national bank, was found inapplicable to the actions of the FRB. The court took notice of FRB's reference to the general rule that a "pledge of collateral for new money does not constitute a preference[,] *Lucas* v. *Federal Reserve Bank,* 59 F.2d 617, 621 (4th Cir. 1932)" and the fact that the FRB, under Regulation A, 12 C.F.R. 201.2, was authorized to extend emergency credit to member banks in "exceptional circumstances." As a matter of policy, the court below felt that the ability of Federal Reserve Banks

> "[t]o serve their function may be inhibited if loans to a national bank suffering liquidity problems are subject to reexamination after the event, on the basis of court determination of insolvency or the likelihood of insolvency at the time emergency action was taken."

The claims against the Comptroller individually and in his official capacity, were dismissed likewise on sovereign immunity grounds pursuant to the Federal Tort Claims Act, 28 U.S.C. §2680(a), (h). The district court noted that the Comptroller had worked for several months prior to October 8, 1974 on plans for a long-term solution to FNB's problems. The Comptroller had declared FNB insolvent after FDIC had worked out a plan to assure the continuance of FNB banking services and after the FRB had informed him on October 7, 1974 that continued emergency credit to FNB would not be in the public interest.

The claims against EAB stemmed from its failure to assume the Huntington financing. The circumstances surrounding this claim were that, after the declaration of insolvency, EAB had advanced $100,000 on behalf of Huntington to Ikenson Iron Works, Inc., a subcontractor for the steel framework of Huntington's building. In connection with this advance, a Mr. Rilke, Vice President of EAB

in charge of the transaction, asserted that he gave no assurances that financing would continue. To the contrary was the affidavit of Mr. Ikenson of Ikenson Iron Works, who asserted that Mr. Klaus Jacobs of EAB told him when the $100,000 EAB check was issued that "[w]e intend to finance construction of the job because we have a commitment to Long Island . . . ." Faced with the above and other conflicting assertions, the district court took into account plaintiffs' concession that there was no agreement in writing binding EAB, and also the parties' agreement that advances under a mortgage are subject to the N. Y. Statute of Frauds, New York General Obligations Law (N.Y.G.O.L.) §5-703(1). Accordingly, the court held,

> "Even if the alleged statements of EAB officers about continuing the financing of the building were sufficiently firm and definite to constitute an agreement, the advance of $100,000 by EAB would not be an equitable reason for avoiding the statute of frauds."

Plaintiffs had also argued that even if the purported Huntington-EAB agreement was subject to the Statute of Frauds, the equitable doctrine of part performance, N.Y. G.O.L. §5-703(4), applied in this case to make the oral contract enforcible. The alleged part performance here was the $100,000 EAB check to Ikenson Iron Works, Inc. on behalf of Huntington. This contention also failed, because the district court decided that New York law requires the alleged part performance to be "unequivocally referable" to the oral agreement, *Gracie Square Realty Corp.* v. *Choice Realty Corp.*, 305 N.Y. 271, 279-80, 113 N.E.2d 416 (1953). The district court found that the $100,000 EAB advance "was merely an expensive way of keeping plaintiffs in operation until EAB could determine whether it was willing to assume a building loan agreement with plaintiffs." The October 8, 1974 agreement explicitly provided that

any advance to an FNB customer by EAB, if made within 180 days after FNB's closing, did not prevent EAB from thereafter rejecting the loan.

As to plaintiffs claim of a fraudulent transfer by which the FRB allegedly acquired an illegal priority over former FNB assets retained by FDIC as Receiver, through the October 8, 1974 agreement, the district court ruled that EAB was entitled to the protection of a *bona fide* purchaser, primarily because EAB had submitted a competitive bid for the FNB assets it subsequently acquired, including a $125 million premium over the book value of those assets. Accordingly, the court ruled that "EAB cannot be charged with any fraud which impairs its title to assets which it acquired."

The gist of appellants' first claim against the FRB is that the large credit extension afforded FNB from May through early October, 1974, should not have been made available in light of FNB's hopeless financial situation throughout that period and that failure to disclose the insolvency to appellants constituted an actionable tort. As mentioned by the district court, appellants' complaint alleged "that FRB made substantial advances to maintain Franklin's liquidity and permit uninsured depositors and general creditors to withdraw their funds from Franklin." Against this unusual theory of why the FRB was willing to stake well over a billion dollars on FNB's survival is the FRB's public explanation of May 12, 1974 that "[a]s a matter of general policy the Federal Reserve makes credit extensions to member banks, upon acceptable collateral, so long as the honoring member bank is solvent." Two days prior to this statement, the FRB had been formally assured in writing of FNB's solvency by the Acting Comptroller of the Currency. In addition, appellants' own citation in their Brief to H. Rep. 94-1669 (*Adequacy of The Office of The Comptroller of The Currency's Supervi-*

sion of Franklin National Bank), 94th Cong., 2d Sess. (1976), a report of an investigation by a subcommittee of the House Committee on Government Operations, makes clear that during the period when FRB was extending credit to FNB, the Comptroller directed his efforts towards finding a suitable merger partner for FNB in order thereby to avert the liquidity crisis. What emerges from these sources is the attempt by the FRB to save FNB from insolvency by affording the Comptroller valuable time to seek and find a solution which would preserve the maximum possible value of FNB's assets, and at the same time minimize the effects of an insolvency on the banking industry and the national economy. The FRB was specifically empowered to extend emergency credit to FNB through the Federal Reserve Board's Regulation A, 12 C.F.R. §201.2, enacted pursuant to 12 U.S.C. §301, and through 12 U.S.C. §347b.[1]

Appellants argue that these advances, which in effect was throwing good money after bad, should not have been made, and they now ask this court to set aside these contributions.

Both the fixing of the date of declaration of insolvency by the Comptroller and the granting of rescue funds to FNB by the FRB were exercises of judgment by the public officials concerned and were well within their competence and authority. Absent clear evidence of grossly arbitrary or capricious action on the part of either or both of

1 The House Committee on Government Operations Report, H. Rep. 94-1669 *(Adequacy of the Office of the Comptroller of the Currency's Supervision of Franklin National Bank)*, 94th Cong., 2d Sess. (1976), criticized the soundness of FRB's advances on the ground that "it is a policy of the Federal Reserve in making such advances to first satisfy itself that repayment of the loan can be made without resort to the collateral. Notwithstanding this policy, the Federal Reserve Bank of New York loaned Franklin $1.7 billion, although it had reason to believe that Franklin itself would not be able to repay the loan." *Id.* at 6.

them—a factor which does not appear to be present here—it is not for the courts to say whether or not the actions taken were justified in the public interest, particularly where it vitally concerned the operation and stability of the nation's banking system. Such an adjudication would have to be made in the face of 12 C.F.R. §201.2(e)'s specific authorization for emergency credit to member Federal Reserve banks in the light of "exceptional circumstances or practises involving only a particular member bank."

Moreover, the FRB's handling of this particular financial crisis comports with congressional purpose in approving the Federal Reserve Act itself. The House Committee on Banking and Currency's report on the Federal Reserve Act of 1913, H. Rep. 69 (*Changes in the Banking and Currency System of the United States*), 63rd Cong., 1st Sess. (1913), pointed out that one of the deficiences of the then existing national banking system was a lack of adequate safeguards against "panics and commercial stringencies or any means of alleviating them," (*id.* at 6). Accordingly, one of the enumerated "ESSENTIAL FEATURES OF REFORM" was:

> "(2) General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments as so often in the past." *Id.* at 11.

In short, the FRB in the present situation was doing, for better or worse, what Congress expected it to do under the Federal Reserve Act.

What few precedents there are for this set of circumstances support the conclusion that appellants' tort claim

against the FRB, arising from the advances, may not be adjudicated here. In *Raichle* v. *Federal Reserve Bank*, 34 F.2d 910 (2d Cir. 1929), this court affirmed the dismissal of an action against the FRB based on the bank's restriction of credit through increases in the rediscount rate pursuant to statutory authority. The complaint charged an arbitrary reduction in brokers' loans and a general reduction of security prices. 34 F.2d at 911. In dismissing the action for failure to join the members of the Federal Reserve Board (the issue of lack of jurisdiction was urged by the FRB, but not passed on by the Court of Appeals, 34 F.2d at 910), the court stated that nowhere in the complaint had the plaintiff alleged that the FRB's actions were in bad faith or engaged in with the intention of injuring the plaintiff. Moreover,

> "[it] would be an unthinkable burden upon any banking system if its open market sales and discount rates were to be subject to judicial review. Indeed, the correction of discount rates by judicial decree seems almost grotesque, when we remember that conditions in the money market often change from hour to hour, and the disease would ordinarily be over long before a judicial diagnosis could be made." 34 F.2d at 915.

In *Billings Utility Co.* v. *Advisory Committee*, 135 F.2d 108 (8th Cir. 1943), the plaintiff had requested and been denied a $35,000 loan by the Federal Reserve Bank of Minneapolis. The court found that under the governing statute, the bank was permitted to make the loan, but not required to do so, 135 F.2d at 111, and that the conduct of the bank's officers was "subject only to the restrictions and limitations contained in the act and when they have acted within those limitations, their conduct is not subject to judicial review." *Id.* at 112. *See also*, *Bryan* v. *Federal*

Open Market Committee, 235 F. Supp. 877 (D. Montana 1964) (dismissal for lack of standing, of an action challenging the powers of the Open Market Committee); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975) (customers of a brokerage firm do not have an implied, private right of action to compel the Securities Investor Protection Corp. to grant its protection to a brokerage firm member—the statute involved therein, 15 U.S.C. §78eee(a)(2), provides that the Corporation "may" apply for a judicial decree adjudicating one of the members in need of the protections of the Securities Investor Protection Act of 1970, 15 U.S.C. §78aaa, *et seq.*). In short, the dismissal of appellants' first claim against the FRB was correct, but on the ground of lack of subject matter jurisdiction.

The appellants' second claim against the FRB, charging a preferential transfer of FNB assets to FDIC to the detriment of appellants as general creditors of FNB, must fail as well. The thrust of this claim is that the provisions of the October 8, 1974 Purchase and Assumption Agreement for the sale of FNB's assets, whereby assets retained by the FDIC as Receiver of FNB would be applied first to repaying FRB's $1.7 billion loan to FNB, were invalid in that FRB loaned those funds to FNB knowing of the insolvency or in contemplation thereof. If this allegation were factually correct, it would be contrary to 12 U.S.C. §91, which voids bank transfers after the commission of an act of insolvency, or in contemplation thereof, with a view to the preference of one creditor over another. The district court was correct in holding that FRB is not a necessary party to this claim, because the same October 8, 1974 Purchase and Assumption Agreement that allegedly created the preferential transfer of FNB assets also provided for the release of FRB's lien to EAB with respect to the assets purchased by or transferred to it, and to

FDIC as a corporation with respect to the remaining assets. FDIC thereafter became responsible for repaying the entire $1.7 billion FRB loan. If appellants' preferential transfer claims were meritorious, the proper party affected would be the FDIC and not the FRB.

With respect to the claims against the Comptroller, appellants' arguments for imposing liability on James E. Smith, individually and in his official capacity, are that: (1) he failed to declare an insolvent bank insolvent; (2) he declared an insolvent bank solvent; (3) he kept an insolvent bank open; (4) he consented to an unlawful preference among creditors in violation of 12 U.S.C. §194; and (5) he failed to take action to have those preferential liens declared null and void. Insofar as the complaint seeks monetary damages against the Comptroller for acts or omissions in carrying out his official duties, this is a suit against the United States, which may not be maintained absent consent by the Government, *Hawaii* v. *Gordon*, 373 U.S. 57 (1963). The Federal Tort Claims Act, 28 U.S.C. §2680(a), prohibits claims against the Federal Government which are based on "the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused." Under 12 U.S.C. §191, the Comptroller "may" appoint a receiver "whenever . . . [he] shall become satisfied of the insolvency of a national banking association . . . ." Needless to say, the process of determining the point at which a bank is no longer able to meet its obligations as they fall due involves a substantial amount of discretion. As the Supreme Court wrote in *Dalehite* v. *United States*, 346 U.S. 15, 36 (1953), a suit under the Federal Tort Claims Act against the United States to recover for losses sustained as a result of explosions of fertilizer with an ammonium nitrate base at

Texas City, Texas: "Where there is room for policy judgment and decision there is discretion."

Much the same analysis and conclusions apply to the claims against the Comptroller individually. It is well settled that federal officials are not personally liable for alleged torts based upon acts committed within the scope of their official duties requiring the exercise of judgment or discretion, *Barr* v. *Matteo*, 360 U.S. 564 (1959); *Howard* v. *Lyons*, 360 U.S. 593 (1959); *Ove Gustavasson Contracting Co.* v. *Floete*, 299 F.2d 655, 658 (2d Cir. 1962), *cert. denied*, 347 U.S. 827 (1963); *Gregoire* v. *Biddle*, 177 F.2d 579, 581 (2d Cir. 1949), *cert. denied*, 339 U.S. 949 (1950). This court wrote in *Ove Gustavasson Contracting Co.* v. *Floete, supra*, that deciding whether the official in question has performed a discretionary act involves answering the question whether "the act complained of [is] the result of a judgment or decision which it is necessary that the Government official be free to make without fear or threat of vexatious or fictitious suits and alleged personal liability?" 299 F.2d at 659. In the present case, the answer to this question must be in the affirmative for sound reasons of policy.

Accordingly, the dismissal of the claims against the Comptroller is hereby affirmed.[2]

2 *Economou* v. *United States Department of Agriculture*, 535 F.2d 688 (2d Cir. 1976), *cert. granted*, —— U.S. —— (1977), granting only a qualified immunity to certain executive officials of the federal government in an action brought under 42 U.S.C. §1983, is not to the contrary. *Economou* sets forth broadly applicable standards governing the immunity available to executive officials. But the case contemplates examination of the discretionary function performed by the individual official and does not purport conclusively to bar the availability of absolute immunity, 535 F.2d at 696. Here the breadth and character of the discretion exercised by the Comptroller under 12 U.S.C. §191 in declaring himself "satisfied" as to a bank's insolvency makes this a clear case calling for granting absolute immunity.

There are also claims gainst EAB, which took over a large portion of FNB's former banking business. As noted earlier in this opinion, the facts surrounding the cessation of credit to Huntington following FNB's insolvency were that Carey wanted EAB to advance $100,000 to Ikenson Iron Works, Inc., on behalf of Huntington in connection with the building of Huntington Towers II and to continue the financing of the building to its completion. A meeting of EAB representatives, Carey and Ikenson was held at the main office of EAB on October 18, 1974, 10 days after the declaration of FNB's insolvency. At this meeting, Ikenson was given an EAB check for $100,000, and Carey signed a note in the same amount payable to EAB. Assurances of continued financing were allegedly given at that meeting by Mr. Klaus Jacobs of EAB, but no new loan agreement providing for future advances was entered into between Huntington, Carey and EAB, and thereafter, there was no further financing on Huntington Towers II by EAB. The legal question which naturally arose from these facts was whether the New York Statute of Frauds, N.Y.G.O.L. §5-703 (McKinney), voided the purported oral agreement by EAB for the continued financing of Huntington Towers II. The district court held that the Statute of Frauds was controlling and precluded appellants' recovery on their first cause of action for monetary damages resulting from the termination of the financing of their building.

N.Y.G.O.L. §5-703(1) provides that an "estate or interest in real property . . . or any trust or power, over or concerning real property, or in any manner relating thereto, cannot be created . . . unless by act or operation of law or by a deed or conveyance in writing . . . ." New York case law applying this ancient rule, including *Sleeth* v. *Sampson*, 237 N.Y. 69 (1923), and *Donahue* v. *Manufactur-*

ers Trust Co., 10 Misc.2d 298 (Sup. Ct., Westchester Co. 1957), establishes that a contract to give a mortgage is a contract for the sale of an interest in real property. In the present case, paragraph 9 of the plaintiffs' complaint specified that the original, 1973 financing agreement between Huntington, Carey and FNB had provided for advances by FNB up to a total of five million dollars "against a commitment from a responsible lending institution to issue a permanent mortgage on the completed building in the said amount." In June of 1974, at FNB's request, appellants had provided FNB with additional security, consisting of "certain mortgages on unimproved real property including the real property hereinabove referred to [Huntington Towers II]." Appellants' complaint, at ¶11. Appellants' original arrangement with FNB was, for purposes of the New York Statute of Frauds, a contract in writing to give a mortgage. As for the purported second financing agreement, this time with EAB, appellants do not claim that its terms and provisions, including mortgage security provisions, were any different from those with FNB. Accordingly, it logically follows that this purported financing agreement with EAB was likewise governed by N.Y.G.O.L. §5-703 as a contract to give a mortgage, and was, therefore, void because it was not in writing.

Appellants' argument on appeal that pursuant to 12 U.S.C. §371, the purported financing by EAB of Huntington Towers II was a commercial loan and that this Federal statute takes the agreement in question out of the provisions of the New York Statute of Frauds is simply not persuasive. 12 U.S.C. §371 authorizes national banks to make real estate and other types of loans, and specifies security requirements for various forms of financing. This federal statute does not purport to define real estate, or

contracts to give a mortgage, or anything of the sort. It is inapplicable to this dispute and can in no way be said to preempt state law on the issue of whether the Statute of Frauds bears upon controversies such as the present case.[3]

Appellants further seek to escape the application of the Statute of Frauds through the equitable doctrine of part performance, N.Y.G.O.L. §5-703(4). The alleged part performance was EAB's $100,000 advance to Ikenson Iron Works on behalf of Huntington. Significantly, appellants have not alleged the partial performance by themselves into which they entered in reliance upon the promise of EAB to the appellants' detriment. They concede, however, that the part performance doctrine has been qualified in New York through judicial interpretation in cases such as

3 Even were we to be persuaded that the New York Statute of Frauds should not be applied here, appellants have shown no more than preliminary negotiations between themselves and EAB, insufficient to constitute a binding oral agreement. The January 23, 1976 Affidavit of Seymour Ikenson of Ikenson Iron Works, Inc., who was present at the October 18, 1974 meeting between officials of EAB and appellant Carey, states that Mr. Klaus Jacobs of EAB told Ikenson at that time that, "We [EAB] intend to finance construction of the job [Huntington Towers II] because we have a commitment to Long Island . . . Nothing will change." The words, "Nothing will change," may be interpreted to mean that EAB would continue financing Huntington Towers II on the same terms as had FNB; it could, however, just as easily be interpreted to mean that the parties would meet at a future time to discuss the terms and conditions of EAB's continued financing. New York law is clear in holding that where "'a material element of a contemplated contract is left for future negotiations, there is no contract enforcible under the statute of frauds or otherwise.'" *Willmott* v. *Giarraputo*, 5 N.Y.2d 250, 184 N.Y.S.2d 97, 98 (1959). As Professor Corbin has correctly pointed out: "Vagueness of expression, indefiniteness and uncertainty as to any of the essential terms of an agreement have often been held to prevent the creation of an enforceable contract." *Corbin on Contracts*, §95 at 394 (1963 ed.) (citing cases in omitted footnote). To construct a complete and detailed financing agreement between appellants and EAB on Mr. Jacob's alleged "Nothing will change" statement goes against common sense and the time-honored maxim that "neither the court nor the jury can make an agreement for the parties." *Thompson* v. *Gortner*, 73 Md. 474, 21 A. 371 (1891).

Burns v. *McCormick*, 233 N.Y. 230, 135 N.E. 273 (1922) and *Wilson* v. *LaVan*, 22 N.Y.2d 131, 238 N.E.2d 738, 291 N.Y.S.2d 344 (1968), which have held that the part performance in question

> "must be performance 'unequivocally referable' to the agreement, performance which alone and without the aid of words or promise is unintelligible or at least extraordinary unless as an incident of ownership assured, if not existing." *Burns* v. *McCormick*, *supra*, 233 N.Y. at 232, 135 N.E. at 273.

Applying the above standard to the facts of this case, the district court was plainly correct in ruling that appellants could not avail themselves of the part performance doctrine. Although perhaps unknown to appellants at the time, EAB was allowed to select particular FNB assets for purchase pursuant to the October 8, 1974 Purchase and Assumption Agreement.

The dismissal of the first claim against EAB, based on its refusal to continue the financing of Huntington Towers II, is affirmed.

As to the appellants' second claim against EAB, the preferential transfer claim, the district court ruled that EAB was entitled to dismissal on the grounds that it was a *bona fide* purchaser of FNB assets. This conclusion followed from the court's findings that "EAB had received definite assurances of the validity of FDIC's sale" and that the EAB bid was a "competitive" one. On this appeal, appellants characterize the *bona fide* purchaser status of EAB as a "non-issue in the case." They argue that there was no basis below to support the *bona fide* purchaser defense on the grounds that EAB played an active role in structuring "the deal that it would ultimately bid on," which in turn gave rise to doubt about the arm's length

nature of the bargain and thus, EAB's *bona fide* purchaser status. In addition, the Trustee in Bankruptcy of FNB, as *Amicus Curiae*, has submitted a short memorandum to this court arguing that the complex *bona fide* purchaser issue was "not explored in the papers filed with the district court . . ." and need not be reached to resolve the present issues.

The Trustee in Bankruptcy also urges that appellants' claim against EAB on the alleged preferential transfer, as well as EAB's defense of *bona fide* purchaser, is premature. We agree. This claim is premature because at this point the appellants have not yet established their claim against FNB. This status derives from their transmittal to FNB of collateral allegedly worth $3,000,000 in June of 1974 to secure further advances for the financing of Huntington Towers II.[4] Upon trial of their claims for a rescission against FNB (in liquidation) and EAB as assignee or (if EAB establishes its *bona fide* purchaser status) then against FDIC, appellants first have to establish their right to the ownership of the excess collateral over the debt for which it was pledged before they are entitled to the legal or equitable relief sought.

Appellants have alleged in their complaint that the sale to EAB was not to a *bona fide* purchaser but was fraudulent; they should be afforded the opportunity at the trial to prove this. Success in this effort, however, would not revive EAB's alleged agreement to continue the Huntington II financing, which we have ruled to be barred by the Statute of Frauds, but instead would give rise to a claim for damages resulting from EAB's fraudulent conduct.

4 The district court ruled that as to the $3,000,000 collateral, appellants may continue their case against the Receiver as a claim for "rescission." We agree and point out that appellants may recover that portion of their collateral in excess of their advancements and other indebtedness due by the pledgors to FNB.

While we agree that the preferential transfer claim is premature as against EAB, we reverse the district court's dismissal of this claim against EAB and order that it be tried along with the remaining claims against FNB (in liquidation) and FDIC, matters which are not presently before us on this appeal.

It is so ordered.

APPENDIX B

Memorandum and Order of Judd, J.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF NEW YORK

HUNTINGTON TOWERS, LTD. and RICHARD CAREY,
Plaintiffs,

against

FRANKLIN NATIONAL BANK (in liquidation), FEDERAL DEPOSIT INSURANCE CORPORATION, FEDERAL RESERVE BANK OF NEW YORK, EUROPEAN-AMERICAN BANK and JAMES SMITH, individually and as Comptroller of the Currency,
Defendants.

July 1, 1976

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Judd, J.

MEMORANDUM AND ORDER

The Motions

In this $8 million action by a borrower from the now insolvent Franklin National Bank (Franklin), each of the five named defendants had moved to dismiss the complaint:

1. Federal Deposit Insurance Corporation as Receiver of Franklin National Bank (in liquidation), (Receiver), moves for dismissal under F.R.Civ.P. §12(b)(6) for failure to state a claim on which relief may be granted.

2. Federal Deposit Insurance Corporation, in its corporate capacity (FDIC), moves to dismiss for lack of subject matter jurisdiction under F.R.Civ.P. §12(b)(1) and also for failure to state a claim under F.R.Civ.P. §12(b)(6).

3. Federal Reserve Bank of New York (FRB) moves to dismiss for failure to state a claim under Rule 12(b)(1) and lack of subject matter jurisdiction under Rule 12(b)(6).

4. European-American Bank & Trust Company (EAB), sued as European-American Bank, moves to dismiss under Rule 12(b)(6) or for summary judgment under F.R.Civ.P. 56. It also moves to stay discovery until the final disposition of the motions.

5. Defendant James E. Smith, individually and as Comptroller of the Currency (the Comptroller) moves to dismiss for lack of subject matter jurisdiction or in the alternative for summary judgment.

THE COMPLAINT

Jurisdiction is invoked under the federal question category, 28 U.S.C. §1331. The presence of FDIC as a defendant also gives independent jurisdiction under 12 U.S.C. §1819, Fourth.

Plaintiff Huntington Towers, Ltd. (Huntington) is a New York corporation, owned by plaintiff Carey, and engaged in real estate development on Long Island. Franklin National Bank (Franklin) agreed in November 1973 to advance sums necessary up to a total of $5 million to construct a building on a parcel of land owned by Huntington. Financing was conditioned on plaintiffs' obtaining a permanent mortgage commitment. The commitment was obtained, construction was begun, and a major tenant was secured, and substantial funds were advanced. On or about June 14, 1974, at Franklin's request, plaintiffs pledged real estate mortgages worth over $3 million as additional security for monies advanced and to be advanced under the November 1973 agreement.

Meanwhile, Franklin is alleged to have become insolvent on or about May 1, 1974 and defendants Franklin, FDIC, FRB, and the Comptroller are charged with jointly concealing the insolvency for several months so that Franklin could continue in operation. As part of this plan, the complaint charges that FRB made substantial advances to maintain Franklin's liquidity and permit uninsured depositors and general creditors to withdraw their funds from Franklin. As security for the advances, FRB was given liens on substantial portions of Franklin's assets. Franklin, FDIC, FRB, and the Comptroller are also al-

leged to have known that Franklin, although insolvent, was continuing to conduct its banking business, and that customers were relying on its ability to perform its banking functions.

On October 8, 1974 the Comptroller declared Franklin insolvent and appointed FDIC as Receiver. Under an agreement of the same date, the Receiver turned over to EAB substantial blocks of Franklin's assets. EAB thereafter succeeded to the operation of Franklin's business and conducted business with Franklin's customers. The complaint alleges that representatives of Franklin, FDIC, and EAB assured plaintiffs that financing of its construction would continue, but that further financing was not provided. Having pledged mortgages as security for future advances in reliance on Franklin's appearance of solvency, plaintiffs have been unable to complete the building. They have gone into default with contractors and materialmen and face loss of their properties by foreclosure. Damages are claimed of approximately $8 million.

The second claim in the complaint is based on assertions that FRB knew of Franklin's insolvency at the time it acquired liens on Franklin's assets, that there will be few or no assets available for Franklin's general creditors, and that Franklin, FDIC, FRB, and the Comptroller deliberately concealed Franklin's insolvency. As a result, the grants of security to FRB are alleged to be null and void under 12 U.S.C. §91, and to constitute "a fraud on the general creditors of Franklin." Plaintiffs seek a declaratory judgment that FRB is not entitled to any security interest or preference as against them in respect of assets of Franklin. Plaintiffs also seek an injunction against FDIC's recognition of any such security interest.

Appendix B

Other Facts

The Comptroller's affidavit in support of his motion for summary judgment sets forth that as of December 31, 1973 Franklin was the twentieth largest bank in the United States, with $5 billion of resources, $3.7 billion of total deposits, and 103 branches in addition to its main office. The stock of its holding company, Franklin New York Corporation (FNYC), was publicly owned, and registered with the Securities & Exchange Commission. A regular examination of Franklin by the Comptroller, begun on November 14, 1973 and concluded on March 8, 1974, showed that Franklin's total resources had grown much faster than its capital; that its growth had been financed almost entirely by short-term borrowed funds representing about 50 percent of the bank's liabilities; and that it had loans which were subject to criticism, although not necessarily uncollectible, amounting to more than its equity capital of $170 million.

During the week of May 6, 1974, the Comptroller's Office and the Federal Reserve System learned from Franklin that severe losses had occurred in its foreign exchange department, that announcement of these losses would cause a severe liquidity crisis, and that an immediate and massive loan from FRB might be necessary. On May 12, 1974, FNYC, Franklin's parent corporation, announced that the foreign exchange department of Franklin had sustained losses of $12 million and that additional losses might be as high as $25 million. Trading in securities of FNYC was promptly suspended. These announcements caused a large run-off of borrowings, in spite of the announcement

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that the Federal Reserve System would advance funds to Franklin as needed, within the limits of acceptable collateral. Within ten days (by May 22, 1974), the loans from FRB reached an amount of $1.125 billion.

Between May and October, the Comptroller's Office endeavored to develop long-term solutions to Franklin's problems, including efforts to obtain help from other banks with its liquidity problems, to arrange a purchase of Franklin by some other bank, and to negotiate with FDIC to assist a purchase and assumption of Franklin's assets and liabilities by another commercial bank. A substantial impairment of the bank's equity capital was revealed by a special examination begun on August 14, 1974. By October 7, 1974, FRB informed the Comptroller that continuation of its credit assistance to Franklin (which amounted to $1.768 billion on October 2nd) would no longer be in the public interest. The Comptroller declared Franklin insolvent at 3:00 p.m. on October 8, 1974.

The Comptroller asserts that he had no part in any decisions concerning specific customers of the bank, and took all his actions in pursuance of his official duties as Comptroller of the Currency.

Plaintiffs in turn quote statements of the Comptroller to the House Comitee on Banking on July 17, 1975 as indicating that there was no hope for Franklin after the events of May 1974, and assert that the facts show that the Comptroller knew the bank was insolvent at that time and was simply endeavoring to gain time so as to avoid public knowledge that Franklin would fail.

By July 2, 1974 the Comptroller had written to the FDIC asking that it make plans for an "assisted take over," which

is possible only in the case of an insolvent bank. A statement of the Federal Reserve at the House hearings described the primary purpose of the loans to Franklin as being a belief that the closing of Franklin "could have precipitated other bank failures with resulting large losses for many individuals and businessmen and for the Federal Deposit Insurance Corporation." The situation was particularly sensitive because of the difficult period then existing for financial institutions and financial markets. FRB considered that failure of Franklin at that time "could, in [its] judgment, have had serious adverse consequences for the stability of our nation's banking system. . . ." The Chairman of the FDIC testified at the House hearings that "[w]e were doing our best to maintain some cloak of secrecy over our actual negotiations and discussions in order not to have even more traumatic impact upon public confidence in banks. . . ."

The Receivership Transactions

Shortly before Franklin was declared insolvent, FDIC had solicited bids for some of Franklin's assets from several banks, on the basis of a proposed purchase and assumption agreement. EAB was the highest bidder, offering a premium of $125 million. On the same day that FDIC was appointed Receiver, it executed a Purchase and Assumption Agreement with EAB under which EAB agreed to assume Franklin's deposit liabilities and certain other specified liabilities (then in the neighborhood of $1.5 billion), and to purchase assets of Franklin of an equivalent value (less the premium), to be selected by EAB. FDIC in its corporate

capacity agreed to hold EAB harmless from any other claims of Franklin creditors and to conduct the defense of any such claim at its own expense.

With respect to the FRB debt, FDIC in its corporate capacity assumed the debt, and FRB released its lien on those Franklin assets which EAB might select. On the same day FDIC as Receiver sold to FDIC as a corporation the remaining assets of Franklin, not selected by EAB; FDIC agreed tc liquidate them and use the proceeds to pay the principal and interest due FRB, the cost of liquidation, and certain other related items, and to remit any excess to the Receiver as "contingent consideration" for the remaining assets.

It is a reasonable inference from the facts that the mortgages pledged with Franklin by plaintiffs on June 14, 1974 are not among the assets finally selected by EAB. Mortgage commitments were not among the liabilities which EAB assumed under Section 2 of the Purchase and Assumption Agreement.

The sales of assets by FDIC as Receiver to EAB and to itself as a corporation were approved by this court *ex parte* under 12 U.S.C. §192 and 12 U.S.C. §1823, with the statement that

> The rights of creditors remain against the receiver and the assuming bank, and do not create any obstacle to the approval of the agreement.

In re Franklin National Bank, 381 F. Supp. 1390, 1393 (E.D.N.Y. 1974).

Post Receivership Negotiations With Plaintiffs

The supporting affidavits on the EAB motion set forth that there is no written agreement concerning any loan commitment to plaintiffs in its files or in the Franklin files which it took over. Plaintiffs who were old customers of Franklin, do not assert that there was any written commitment by Franklin to make a loan.

There was one advance by EAB after October 8, 1974. A check of $100,000 was issued to Ikenson Iron Works, Inc. on October 18, 1974 on behalf of Huntington, in reliance on a note for $100,000 signed by plaintiffs. The note is presently in default. Mr. Rilke, the Vice-President of EAB in charge of the transaction, asserts that he gave no assurances that financing would continue. He also asserts that completion of plaintiffs' building project was not scheduled before November 1975, more than a year after issuance of the Ikenson check.

Mr. Ikenson whose company was a subcontractor for the steel framework on plaintiffs' building, states in his affidavit that a Mr. Klaus Jacobs of EAB told him when the $100,000 check was issued that "[w]e intend to finance construction of the job because we have a commitment to Long Island," and that Mr. Rilke agreed to honor another $80,000 check the following week, but did not do so. Mr. Carey's affidavit confirms these statements, and asserts that he could have completed construction of the building within one year from October 18, 1974. He also asserts that FDIC's chief liquidator told him in November 1974 that it was in FDIC's interest to get the building built so that they would not lose money.

A "funding request" from Vice-President Rilke of EAB to the Senior Vice-President of the Real Estate Banking Department on October 17, 1974 described Mr. Carey's requirements of $500,000 of additional money and stated, "[m]eanwhile it is important to provide funds to enable the continuance of the construction project which should enhance the overall situation." This memorandum, which preceded the $100,000 advance by one day, was not delivered to plaintiffs, but was obtained by their counsel through a request for documents under the Freedom of Information Act.

Relevant Statutes

12 U.S.C. §91. Transfers by bank and other acts in contemplation of insolvency

All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in

any suit, action, or proceeding, in any State, county, or municipal court.

12 U.S.C. §191. General grounds for appointment of receiver

Whenever any national banking association shall be dissolved, . . . or whenever the comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, in either case, appoint a receiver who shall proceed to close up such association . . . .

12 U.S.C. §192. Default in payment of circulating notes

. . . Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct . . . .

12 U.S.C. §194. Dividends on adjusted claims; distribution of assets

From time to time, . . . the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, . . .

Discussion of Law

I. *Motion of Franklin National Bank (in liquidation)*

One aspect of the claim against Franklin is that it agreed to lend plaintiffs money and did not lend it. This is a breach of contract, or an anticipatory breach, which is presumably actionable, although the extent of damages has not been briefed and the value of a general claim against the receivership estate may be doubtful.

The fact that no advance was due on the plaintiffs' loan at the precise moment of receivership does not mean that they have no provable claim against the Receiver. The cases cited by FDIC do not defeat the existence of a claim. *Argonaut Savings & Loan Association* v. *Federal Deposit Insurance Corporation,* 392 F.2d 195 (9th Cir. 1968) was a case where the FDIC gave written notice of disaffirmance of plaintiff's lease several months before plaintiff exercised its option to terminate the lease. *International Westminster Bank, Ltd.* v. *Federal Deposit Insurance Corp.,* 509 F.2d 641 (9th Cir. 1975) involved claims on letters of credit, of which all but two had been paid and the remainder might be paid. Here plaintiff's claim, if valid, was directly against Franklin; and there was no one else to satisfy the claim.

A second aspect of the claim is that plaintiffs would not have given Franklin additional security on June 14, 1974 if they had known that Franklin was then insolvent and would not be able to complete the financing.

The Receiver disputes the validity of this claim under *Dwelle-Kaiser Co.* v. *Aetna Casualty & Surety Co.,* 241 N.Y. 464 (1926), which it interprets as meaning that the

insolvency of one party to a contract does not relieve the other of its obligation to perform, and thus that there is no obligation to disclose insolvency. In *Dwelle-Kaiser* a surety company took over performance of a contract after the general contractor went bankrupt; it procured completion of a subcontract on the basis of orders from the general contractor, and did not pay the subcontractor. The court found that there was no duty to inform the subcontractor of the insolvency, that the subcontractor still had to perform its contract and that the only effect of the insolvency would be to permit it to demand cash payment for materials furnished. See also *Hanna* v. *Florence Iron Co.,* 222 N.Y. 290 (1918).

The complaint in this case is not precise as to the nature of plaintiffs' agreement with Franklin. If the subcontractor in *Dwelle-Kaiser* "could have demanded cash payment" upon learning of the insolvency (241 N.Y. at 468), the plaintiff here could perhaps have delivered their additional security in installments, concomitant with future advances by Franklin. *Cf. Pardee* v. *Kanady,* 100 N.Y. 121, 126-27 (1885). The complaint should not be narrowly construed on a motion to dismiss for failure to state a claim upon which relief may be granted. The court cannot now determine what actual facts may be proved or what the measure of damages may be. It may well be that in June of 1974 the Franklin officers still believed that their bank was solvent. In any event, the case should be permitted to proceed.

On this phase it does not matter whether the claim against Franklin charges deceit. The Receiver is in a different position from FDIC as a corporation with respect to the Federal Tort Claims Act. Under the provisions of 28 U.S.C. §2679(a) in conjunction with 28 U.S.C. §2680(h), FDIC as a federal agency cannot be sued for misrepresentation or deceit. Insofar, however, as plaintiffs' claim rests on misrepresentation by Franklin before the receivership, proof of the claim against the Receiver is not forbidden by Section 2679. A claim for a tort committed by Franklin before receivership is provable as a claim against the receivership estate. *Corbin* v. *Federal Deposit Insurance Corporation,* (E.D.N.Y. 75-C-2144, Oral Memorandum of June 18, 1976). There is no basis for holding that a claim which would have been valid against a bank or a private receiver is invalid against FDIC as Receiver.

Insofar as the claim against the Receiver is based on statements made by Franklin officers or FDIC officials after the receivership, the situation is different.

Plaintiffs' claim against the Receiver cannot be supported by conversations after Franklin was placed in receivership. At such a time officers of the bank can no longer subject it to any obligation. *Bryce* v. *National City Bank,* 17 F. Supp. 792, 797 (S.D.N.Y. 1936), *aff'd,* 93 F. 2d 300 (2d Cir. 1937). The further statements said to have been made by FDIC employees could not bind the Receiver, first because there was no consideration for a promise by the Receiver, and second because they did not rise to the level of formality necessary for the adoption of a contract by a Receiver.

Plaintiffs' prayer for relief need not be accepted as a proper measure of its claim. No basis has been shown for

voiding mortgages and notes given to Franklin by plaintiffs, as they demand. Even if plaintiffs establish a claim against Franklin, they still owe Franklin repayment of amounts which were advanced, and Franklin is entitled to the security which was given for such advances.

Plaintiffs may still have two possible claims against the Receiver. The first is for damages for (anticipatory) breach of the agreement to make advances. The second is for rescission of all or part of the transfer of collateral made on June 14, 1974. The court expresses no opinion on the ultimate validity of any such cause of action.

II. *Motion of FDIC as a Corporation*

Plaintiffs' first claim against FDIC for damages for failure to disclose insolvency, is a claim in tort for misrepresentation or deceit, and therefore is not a permissible subject of suit against a federal agency.

There is ample authority that FDIC is "a federal agency" as defined in the Federal Tort Claims Act, 28 U.S.C. §2671, and therefore that sovereign immunity protects it from liability for torts of the type described in 28 U.S.C. §2680, including "misrepresentation, deceit, or interference with contract rights." Section 2680(h). *Safeway Portland Employees' Federal Credit Union* v. *Federal Deposit Insurance Corp.*, 506 F.2d 1213, 1215 (9th Cir. 1974); *AMR Inc.* v. *Federal Reserve Bank,* Civ. No. 44,387 (N.D. Cal. Order of April 28, 1966); *Freeling* v. *Federal Deposit Insurance Corp.,* 221 F. Supp. 955, 957 (W.D. Okla. 1962), *aff'd,* 326 F.2d 971 (10th Cir. 1963); *cf. Edelman* v. *Federal Housing Administration,* 251 F.

Supp. 715, 719 (E.D.N.Y. 1966), *aff'd,* 382 F.2d 594, 596-97 (2d Cir. 1967).

For the same reason FDIC cannot be sued for participation in an alleged fraud on creditors. It has no duty to warn the public concerning the impending insolvency of an insured bank. *Davis* v. *Federal Deposit Insurance Corp.,* 369 F. Supp. 277, 280 (D Col. 1974).

This does not mean that the second claim must be dismissed against FDIC as a corporation, if it received assets of Franklin which were subject to a right of rescission by plaintiffs and which can be traced and identified. An action for equitable or declaratory relief and not for money damages may be maintained. *B. C. Morton International Corp.* v. *Federal Deposit Insurance Corp.,* 305 F.2d 692 (1st Cir. 1962).

A claim for restitution may also be provable against FDIC. *In re Anjopa Paper & Board Mfg Co.,* 269 F. Supp. 241 (S.D.N.Y. 1967).

A question may arise as to whether a claim for restitution can be established if the mortgages which plaintiffs pledged with Franklin were in turn pledged with FRB and came into FDIC's possession subject to the FRB lien. That issue need not be decided now.

This court's decision in *Schy* v. *Franklin National Bank,* 72-C-718 (E.D.N.Y. March 3, 1975), does not prevent pursuing restitution of specific assets in this action. That was a pre-receivership action against Franklin for making loans alleged to have been in violation of Regulation U of the Federal Reserve System. Parallel cases in other districts against other banks had been consolidated by the Judicial Panel on Multidistrict Litigation for transfer to the Southern District of New York. *In re The Susque-*

hanna Corporation Securities Litigation, MDL #197. The attack on transfers to FDIC was not focussed on specific assets in the *Schy* case. This court refused to complicate that multidistrict litigation by granting a request for joinder of an alleged transferee under F.R.Civ.P. 25(c), saying (p. 9):

> Judiciary economy would favor making a determination of FDIC's corporate liability in an action where rights of other solvent banks are not at issue, and after Franklin's liability has been established.

The *Schy* case, in its application here, means that parties whose claim is unliquidated, and whose status as creditors is disputed, should not be permitted to challenge the general validity of FDIC's lien, or its selection of liabilities which should be assumed by EAB, in the same case where they seek to establish their status as creditors. Even if plaintiffs establish a right to damages, it may be fully offset by the amount of advances made by Franklin. The corporate liability of FDIC is not prematurely raised, however, insofar as the complaint relates to restitution of specific assets which may be in the possession of FDIC.

Since plaintiffs' claim is not for tort, the requirement of first presenting the claim to FDIC under 28 U.S.C. §2675(a) is not applicable, even if a corporation like FDIC with a "sue and be sued" clause is subject to the provisions of that section.

The claim against FDIC as a corporation therefore may stand as a claim for restitution of collateral given to Franklin by plaintiffs, but should be dismissed in other respects. The court expresses no opinion on the merits of plaintiffs' claims.

III. *Motion of Federal Reserve Bank of New York*

Although the motion of FRB is based on Rules 12(b)(1) and (6) for failure to state a claim and for lack of jurisdiction over the subject matter, its memorandum cites other documents which are annexed to it. In the light of the documentation on other motions concerning the facts leading up to the receivership of Franklin, it is proper to treat the motion as one for summary judgment under F.R.Civ.P. 56.

In a motion under Rules 12(b)(1) and (6), it might be necessary to accept the statement in the complaint that FRB knew on and after May 15, 1974 that Franklin was insolvent. However, on a motion for summary judgment the court may consider that the acting Comptroller of the Currency by letter of May 10, 1974 had notified the Board of Governors of the Federal Reserve System that

> [a]t the last full examination of the subject bank which terminated on March 8, 1974, the bank was found to have fairly severe credit and liquidity problems, but was adjudged to be solvent. Although the liquidity problem has subsequently become aggravated by adverse rumors circulating in the market place, to date, we have not received any information which would materially alter our March 8, 1974 conclusion that the bank is solvent. If there is any significant change in the condition of the bank, this Office will promptly advise you.

On May 12, 1974, FRB issued a press release stating in part,

> Working with Franklin National, the Federal Reserve Bank of New York has determined that there is a large

> amount of acceptable collateral available to support advances to the bank from the Federal Reserve discount window, if they are needed.
>
> As a matter of general policy, the Federal Reserve makes credit extensions to member banks, upon acceptable collateral, so long as the borrowing member bank is solvent. We are assured by the Comptroller of the Currency that Franklin National Bank is a solvent institution.

Within ten days after May 12, 1974, FRB had advanced more than $1 billion to Franklin on demand notes. Plaintiffs argue that FRB should have known in May 1974 that Franklin was in fact insolvent. This represents an indirect attack on the Comptroller's certification that Franklin was solvent when the FRB advances began. In the view the court takes of the law, plaintiffs' contention does not raise a material issue that can defeat summary judgment for FRB.

Since the first claim against FRB is based on tort liability for failure to disclose the alleged known insolvency of Franklin, it is barred by the Federal Tort Claims Act, 28 U.S.C. §2680(h), for the same reasons described with respect to FDIC as a corporation.

The attempt to impose liability on FRB for granting a secured loan to Franklin is barred also by the provisions of 28 U.S.C. §2680(a), which sets forth that the Federal Tort Claims Act

> . . . shall not apply to—
>
> (a) Any claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

In other circumstances courts have refused to review discretionary acts of the Federal Reserve banks. *Raichle* v. *Federal Reserve Bank,* 34 F. 2d 910 (2d Cir. 1929); *Billings Utility Co.* v. *Advisory Committee,* 135 F.2d 108 (8th Cir. 1943).

Insofar as the second claim in the complaint seeks to attack the lien which FRB received on Franklin assets, it is not appropriate to press the claim against FRB. Under the "Agreement of Assumption of Indebtedness" dated October 8, 1974 between FRB and FDIC as Receiver and as a corporation, FRB released its lien to EAB with respect to the assets purchased by or transferred to it, and to FDIC as a corporation with respect to the remaining assets. FDIC in turn assumed and agreed to pay the entire FRB indebtedness together with interest. If there were any defect in FRB's lien, it might affect the assets in the hands of FDIC, but FRB is not a necessary party to the litigation.

Even if 12 U.S.C. §91 applies to loans from FRB to a member bank, it would be necessary to determine first whether the liens were given "in contemplation" of insolvency, and second whether they were given "with a view to prevent the application of [Franklin's] assets in the manner prescribed by" the National Bank Act "or with a view to the preference of one creditor to another . . ." Section 91 is R.S. §5242 unchanged, and was derived from the National Bank Act of June 3, 1864, 13 Stat. 115 and the Act of March 3, 1873, ch. 269 §2, 17 Stat. 603.

Subsequently the Federal Reserve Act of 1913 gave Federal Reserve banks specific and varied authority to make loans to member banks. 12 U.S.C. §347 permits advances to member banks for periods not exceeding 15 days on promissory notes secured by pledge of United States Treasury indebtedness; and 12 U.S.C. §347(b) provides:

> Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. . . .

Franklin's notes to FRB were for the most part for only one day. There is no evidence that any were for four months. Continuance of short-term loans for over four months does not violate the statutory limitation against notes "having maturities of not more than four months."

It is not claimed by FRB that §347(b) repealed §91; but the two sections should be read in relation to each other, and to the general rule that a pledge of collateral for new money does not constitute a preference. *Lucas* v. *Federal Reserve Bank,* 59 F.2d 617, 621 (4th Cir. 1932). The Federal Reserve banks, as lenders of last resort to their member banks, are given authority to respond to problems which affect individual banks and the banking community as a whole. The General Principles Section of Regulation A, 12 C.F.R. 201.2 in effect in May 1974 provided in part

> (e) Emergency credit for member banks. Federal Reserve credit is available to assist member banks

> in unusual or emergency circumstances such as may result from national, regional, or local difficulties or from exceptional circumstances involving only a particular member bank.

The ability of Federal Reserve banks to serve their function may be inhibited if loans to a national bank suffering liquidity problems are subject to reexamination after the event, on the basis of court determinations of insolvency or the likelihood of insolvency at the time emergency action was taken. In 1 Report of a System Committee, *Reappraisal of the Federal Reserve Discount Mechanism* (1971), p. 19, the Board of Governors stated:

> The Federal Reserve System has a clear responsibility to lend to member banks in both isolated and widespread emergency situations. It is expected that such assist nce would often have beneficial effects for the economy as a whole, but in such cases the immediate responsibility of the System is directly to the member bank. This is one of the benefits of Federal Reserve membership—paid for in a sense by the maintenance of non-earning assets in satisfaction of reserve requirements—and a basic source of confidence in the banking system.

The loans to Franklin by FRB served at least three purposes, not connected with any intent to prefer creditors: First to buy time within which to find a solution to Franklin's problems, second to cushion the impact on the economy which might be anticipated from the failure of a major bank, and third to stave off a liquidity problem which would interfere with adequate study of the Franklin situation.

The situation in *Texas & Pacific Railway Co.* v. *Pottorff*, 291 U.S. 245, 253, 54 S.Ct. 416, 417 (1934) was quite different from the present one. It involved a bank's pledge of part of its assets to secure a private deposit, an act which Mr. Justice Brandeis said was beyond the power of a national bank. It is clear that under present statutes Franklin had power to pledge its assets with FRB and that FRB had power to make the loan here involved. Similar comments apply to *Roberts* v. *Hill*, 24 F. 571, (Cir. Ct. Vt. 1885), on which plaintiffs also place great reliance. That involved a transfer of a note to a single depositor, not a borrowing from a Federal Reserve bank; in fact, the Federal Reserve System was not in existence at the time.

For all the reasons set forth, FRB is not a necessary or proper defendant.

IV. *Motion of European-American Bank*

With respect to the damage claim against EAB, both parties agree that advances under a mortgage are subject to the statute of frauds. New York General Obligations Law §5-703(1); *Donahue* v. *Manufacturers Trust Co.*, 10 Misc.2d 298, 166 N.Y.S.2d 174 (Sup.Ct. West. Co. 1957); *Sleeth* v. *Sampson*, 237 N.Y. 69 (1923).

Plaintiffs concede that there is no agreement in writing binding EAB.

Plaintiffs rely for their first claim on the provisions of Section 5-703(4) that

> Nothing contained in this section abridges the powers of courts of equity to compel the specific performance of agreements in cases of part performance.

The only part performance alleged by plaintiffs, however, is an advance of $100,000 by EAB against a promissory note. Even if the alleged statements of EAB officers about continuing the financing of the building were sufficiently firm and definite to constitute an agreement, the advance of $100,000 by EAB would not be an equitable reason for avoiding the statute of frauds.

Specific performance may be required by an equity court if refusal to enforce an oral contract would cause loss to somebody who has acted in reliance on the contract. See *Cooley* v. *Lobell*, 153 N.Y. 596, 602 (1897). Plaintiffs suffered no detriment, however, from the fact that EAB lent them $100,000 that it was not obligated to lend.

Part performance must also be "unequivocally referable" to the alleged oral agreement. *Gracie Square Realty Corp.* v. *Choice Realty Corp.*, 305 N.Y. 271, 279-80 (1953), quoting from *Burns* v. *McCormick*, 233 N.Y. 230, 232 (1922). The advance of $100,000 by EAB was merely an expensive way of keeping plaintiffs in operation until EAB could determine whether it was willing to assume a building loan agreement with plaintiffs.

As pointed out above, mortgage commitments were not included among the liabilities which EAB assumed under the Purchase and Assumption Agreement. On the contrary, the Purchase and Assumption Agreement made plain that any advance to a Franklin customer by EAB, if made within 180 days after the bank closing, did not prevent EAB from rejecting the loan (¶¶3.5 and 3.6, pp. 17-21).

Insofar as EAB relies on Section 5-701(1) of the General Obligations Law relating to contracts which by their terms cannot be performed within a year, the court agrees with

plaintiffs that there is sufficient dispute about the facts so that this would not justify summary judgment dismissing the claim. *North Shore Bottling Co., Inc.* v. *C. Schmidt & Sons, Inc.*, 22 N.Y.2d 171, 175-76, 292 N.Y.S.2d 86 (1968).

With respect to plaintiffs' second claim, EAB is entitled to the protection accorded a *bona fide* purchaser. Even if there were a violation of U.S.C. §91 by Franklin and FRB, that would not defeat the title which EAB received by purchase from FDIC. EAB had received definite assurances of the validity of FDIC's sale. As is stated in Comment 1 to Section 297 of the *Trusts Restatement (2d)*,

> If the transferee has notice of the existence of a trust and of the terms of the trust, and after using due diligence to ascertain whether the transfer is in breach of trust reasonably believes that the facts are such that the transfer is not in breach of trust, he takes free of the trust if the other reuqirements of bona fide purchase are complied with.

Having submitted a competitive bid and offered a $125 million premium over the book value of the assets it was acquiring, EAB cannot be charged with any fraud which impairs its title to assets which it acquired.

Moreover, FDIC in its corporate capacity under the Indemnity Agreement of October 8, 1974 agreed to indemnify EAB against any claims "of any present or former creditor, customer, or supplier" of Franklin and to conduct the defense of any such claim at its own expense (¶¶1(ii), 3). Since FDIC is solvent, and can recoup any losses by assessments against member banks, there is no justification for keeping EAB as a defendant.

V. *Motion of Comptroller of the Currency James E. Smith*

The Comptroller was engaged for several months, at least from May to October, in developing a long-term solution to Franklin's problems. He declared Franklin insolvent at 3:00 p.m. on October 8, 1974, after FDIC had developed a plan for the sale of enough assets to cover the remaining deposit liabilities and assure the continuance of banking services, and after FRB had informed him on October 7, 1974 that it no longer viewed the continuation of its program of credit assistance to Franklin to be in the public interest.

The claim against the Comptroller is definitely barred by the Federal Tort Claims Act, both as one based on misrepresentation or deceit, under 28 U.S.C. §2680(h), and as one based on "the exercise or performance or the failure to exercise or perform a discretionary function or duty" under 28 U.S.C. §2680(a). There was a square holding to this effect under almost identical circumstances arising from the receivership of the United States National Bank of San Diego. *San Luis Rey Downs, Inc.* v. *Smith* (S.D. Calif. 75-0094, Order entered August 29, 1975). This branch of the action is not even against a federal corporation, but against a federal official and clearly seeks to recover money from the United States Treasury. *Hawaii* v. *Gordon,* 373 U.S. 57, 83 S.Ct. 1052 (1963).

Plaintiffs argue that there must be "a minimal objective standard of insolvency" at which the Comptroller must appoint a receiver. There is no basis in the statute for such a ruling. The language of 12 U.S.C. §191 is that the Comptroller "may" appoint a receiver when he is satisfied of

the insolvency of a national bank. The timing of a receivership is a sensitive matter, on which the Comptroller's discretion should not be hampered by fears of judicial second-guessing. *Liberty National Bank* v. *McIntosh*, 16 F.2d 906, 909 (4th Cir.), *cert. denied*, 273 U.S. 783, 47 S.Ct. 571 (1927); *O'Connor* v. *Bankers Trust Co.*, 159 Misc. 920, 930-31, 289 N.Y.S. 252, 267-68 (Sup. Ct. N.Y. Co. 1936), *aff'd*, 253 App. Div. 714, 1 N.Y.S. 2d 641 (1st Dept. 1937), *aff'd*, 278 N.Y. 649 (1938); *Harmsen* v. *C. Arnholt Smith* (S.D. Cal. Civ. 73-460, Order of July 28, 1975).

The Comptroller is not subject to liability in this action, either in his official capacity or individually.

Conclusion

It is Ordered:

1. That the motion for dismissal of the complaint as against Franklin National Bank (in liquidation) be denied as to the first claim, and granted as to the second claim, except insofar as the second claim seeks to trace the securities described in Paragraph 11 of the complaint;

2. That the motion to dismiss the complaint as against Federal Deposit Insurance Corporation be granted except insofar as it seeks to trace the securities described in Paragraph 11 of the complaint;

3. That the motion of Federal Reserve Bank of New York to dismiss the complaint be granted;

4. That the motion of defendant European American Bank to dismiss the complaint be granted; and

4(a). That the motion to stay discovery against defendant European-American Bank & Trust Company be granted, without prejudice to any discovery which may hereafter be requested of European-American Bank & Trust Company as a witness; and

5. That the motion to dismiss the complaint as against defendant James E. Smith individually and as Comptroller of the Currency, be granted.

There being no just reason for delay with respect to Paragraphs 3, 4, and 5 above, the Clerk shall enter judgment dismissing the complaint as against defendants Federal Reserve Bank of New York, European-American Bank, and James E. Smith, with costs.

/s/ Orrin G. Judd

U.S.D.J.

APPENDIX C

Statutory Provisions Involved

National Banking Act

12 U.S.C. §91. Transfers by bank and others acts in contemplation of insolvency

All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court.

12 U.S.C. §191. General grounds for appointment of receiver

Whenever any national banking association shall be dissolved . . . or whenever the comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, in either case, appoint a receiver who shall proceed to close up such association.

12 U.S.C. §192. Default in payment of circulating notes

. . . Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct. . . .

12 U.S.C. §194. Dividends on adjusted claims; distribution of assets

From time to time, . . . the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, . . .

Federal Reserve Act

12 U.S.C. §347. Advances to member banks on their notes

Any Federal reserve bank may make advances for periods not exceeding fifteen days to its member banks on their promissory notes secured by the deposit or pledge of bonds, notes, certificates of indebtedness, or Treasury bills of the United States, or by the deposit or pledge of debentures or other such obligations of Federal intermediate credit banks which are eligible for purchase by Federal reserve banks under section 350 of this title, or by the deposit or pledge of bonds issued under the provisions of

subsection (c) of section 1463 of this title; and any Federal reserve bank may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this chapter or secured by such obligations as are eligible for purchase under section 355 of this title. All such advances shall be made at rates to be established by such Federal reserve banks, such rates to be subject to the review and determination of the Board of Governors of the Federal Reserve System. If any member bank to which any such advance has been made shall, during the life or continuance of such advance, and despite an official warning of the reserve bank of the district or of the Board of Governors of the Federal Reserve System to the contrary, increase its outstanding loans secured by collateral in the form of stocks, bonds, depentures, or other such obligations, or loans made to members of any organized stock exchange, investment house, or dealer in securities, upon any obligation, note, or bill, secured or unsecured, for the purpose of purchasing and/or carrying stocks, bonds, or other investment securities (except obligations of the United States) such advance shall be deemed immediately due and payable, and such member bank shall be ineligible as a borrower at the reserve bank of the district under the provisions of this section for such period as the Board of Governors of the Federal Reserve Ssystem shall determine: *Provided,* That no temporary carrying or clearance loans made solely for the purpose of facilitating the purchase or delivery of securities offered for public subscription shall be included in the loans referred to in this section.

12 U.S.C. §347b. Advances to individual member banks on time or demand notes; maturities; interest

Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. . . .

Judiciary Act

28 U.S.C. §1361. Action to compel an officer of the United States to perform his duty

The district courts shall have original jurisdiction of any action in the nature of mandamus to compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff.

Federal Tort Claims Act

28 U.S.C. §2680. Exceptions

The provisions of this chapter and section 1346(b) of this title shall not apply to—

(a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part

of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

* * *

(h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights: *Provided,* That, with regard to acts or omissions of investigative or law enforcement officers of the United States Government, the provisions of this chapter and section 1346(b) of this title shall apply to any claim arising, on or after the date of the enactment of this proviso, out of assault, battery, false imprisonment, false arrest, abuse of process, or malicious prosecution. For the purpose of this subsection, "investigative or law enforcement officer" means any officer of the United States who is empowered by law to execute searches, to seize evidence, or to make arrests for violations of Federal law.

In the
Supreme Court of the United States
October Term, 1977
No. 77-564

Huntington Towers, Ltd.
and Richard Carey,
Petitioners,
v.
Franklin National Bank (in liquidation)
and Federal Deposit Insurance Corporation,
Defendants,
Federal Reserve Bank of New York,
European-American Bank, and James Smith,
individually and as Comptroller of the Currency,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT FEDERAL RESERVE BANK OF NEW YORK IN OPPOSITION

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Preliminary Statement

In May 1974, Franklin National Bank ("Franklin National"), then the nation's twentieth-largest bank with large foreign exchange commitments, was faced with a severe and well-publicized liquidity crisis. Without access to funds from the Federal Reserve System, the lender of last resort, a run on the bank which would have forced Franklin National to close its doors was inevitable. It

was entirely possible that the closing of Franklin National in these circumstances would have resulted in a bank panic of incalculable national and international dimensions.

The Comptroller of the Currency ("Comptroller"), whose satisfaction with a national bank's solvency or insolvency is by statute the principal determinant of whether a national bank is to be placed in receivership, determined that Franklin National was solvent although facing a massive liquidity crisis. The Comptroller so advised the Board of Governors of the Federal Reserve System ("Federal Reserve Board").

The Federal Reserve Bank of New York ("Reserve Bank") is authorized by statute to make advances to member banks precisely so as to avoid the consequences threatening Franklin National in particular and the banking system in general. The Reserve Bank is required by statute to obtain collateral satisfactory to it to secure such advances. In accordance with this statutory authority and requirement, the Reserve Bank made massive collateralized advances to Franklin National beginning in May 1974.

Ultimately, on October 8, 1974, the Comptroller became "satisfied" (the statutory term) that Franklin National was insolvent and appointed the Federal Deposit Insurance Corporation ("FDIC") as its receiver. The FDIC that day, with court approval as required by statute and with the release by the Reserve Bank of its lien, sold and transferred most of the assets and liabilities of Franklin National to European American Bank, which continued the banking business of Franklin National without interruption. In its corporate capacity the FDIC assumed primary responsibility for repayment of the advances, aggregating some $1.7 billion, which the Reserve Bank had made to Franklin National. The doors of Franklin

National (under the name of European American Bank) were open the following morning, and the consequences which the precipitous closing of Franklin National in May 1974 would have brought were avoided.

Insofar as it relates to the Reserve Bank, the petition seeks review of the decision of the court of appeals that (i) the district court lacked subject matter jurisdiction of petitioners' claim that the making by the Reserve Bank of the advances to Franklin National constituted a tort and (ii) the presence of the Reserve Bank in the action was not necessary in respect of petitioners' attempt to reclaim collateral they had pledged to Franklin National. Petitioners (together "Huntington") have not presented any sufficient ground for review by this Court or any pertinent authority in support of their position.

Reversal of the decision below, either on the ground that the making of such advances is a justiciable tort or that the Reserve Bank obtained a preference since the advances were collateralized—as the statute requires them to be—would effectively deprive Federal Reserve Banks of their statutory authority to deal with liquidity crises such as that of Franklin National. Such a revision of the statutory scheme for solving banks' liquidity problems is, we submit, for the Congress, not the courts.

Opinions Below

The Memorandum of Decision and Order dated July 1, 1976 of the United States District Court for the Eastern District of New York (Pet. p. A23-A51) has not been officially reported. The Decision and Order of the United States Court of Appeals for the Second Circuit dated July 19, 1977 affirming in part and reversing in part the decision of the District Court (Pet. p. A1-A22) is reported at 559 F.2d 863.

Questions Presented

The principal question which would be presented by a review of the decision of the court of appeals affirming the judgment dismissing the claims against the Reserve Bank is:

> Does the making pursuant to the Federal Reserve Act by a Federal Reserve Bank of collateralized advances to a national bank, which has not been declared by the Comptroller to be insolvent, give rise to a justiciable claim that the Federal Reserve Bank has committed a tort or received an unlawful preference?

Additional questions are presented:

> May the courts determine that the Comptroller "should" have determined a national bank to be insolvent at a date earlier than that when he became "satisfied" of its insolvency and thus that "insolvency" had occurred earlier?
>
> Is the receipt by a Federal Reserve Bank of collateral required for new monies advanced to a national bank an unlawful preference?

We submit that the answer to each of these questions is in the negative.

But there is no need for the Court to reach any of these questions since no basis for a grant of the writ has been made out by the petitioners. The supposed conflict within the Court of Appeals for the Second Circuit does not exist, since the other decision cited deals with issues of personal tort immunity of government officials, not the justiciability of a claim directed against action by a Federal Reserve Bank of the sort involved here. The contention that the decision below violates the principle of ratable distributions ignores the congressional requirement that Reserve Banks make advances only against collateral; there simply is no conflict between recognition of the position of a secured creditor and a requirement that unsecured creditors receive parity of treatment.

Counter-Statement of the Case

The Federal Banking System

The Federal Reserve System was created by Congress to prevent the monetary crises, periodic loss of public confidence in the banking system and runs on banks which had been a feature of the American economy in the nineteenth century and the early part of this century. The System consists of the Federal Reserve Board, whose members are appointed by the President with the advice and consent of the Senate, the twelve Federal Reserve Banks and the Federal Open Market Committee.*

The Federal Reserve Act requires that each national banking association be a member of the system and a stockholder of the Federal Reserve Bank in its Reserve District, 12 U.S.C. § 282 (1970).** One of the principal functions of a Federal Reserve Bank is to make loans to member banks, often on an immediate basis, in order to ensure the efficient functioning and stability of the monetary system, subject to regulations promulgated by the Federal Reserve Board, 12 U.S.C. §§ 301, 347, 347b, 347c

* The Federal Open Market Committee establishes monetary policy which is effectuated principally by purchase or sale of Treasury obligations.

** After providing a fixed return of 6% to the stockholders, virtually all of the net earnings of the Federal Reserve Banks are paid over to the Treasury; in 1976, 97.6%. *Sixty-Third Annual Report of the Board of Governors of the Federal Reserve System, 1976*, 461.

(1970 & Supp. V 1975). The Federal Reserve Board has promulgated Regulation A, 12 C.F.R. §201, to regulate Federal Reserve Banks in carrying out this statutory authority. Such loans must be secured by United States Government securities, 12 U.S.C. § 347c (1970), or otherwise secured "to the satisfaction of" the Federal Reserve Bank, 12 U.S.C. § 347b (Supp. V 1975).

The Comptroller is an official of the Department of the Treasury subject to the general direction of the Secretary of the Treasury, 12 U.S.C. § 1 (1970). He is responsible for the chartering, examination and supervision of national banks, 12 U.S.C. §§ 26, 161 (1970). The statute further provides that he shall appoint a receiver of a national bank in three situations. Two are objective events of insolvency (dissolution upon suit by the Comptroller for charter forfeiture or failure to pay a judgment within 30 days, 12 U.S.C. § 191 (1970)), neither of which occurred here. The third is:

> ". . . whenever the Comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs . . . appoint a receiver who shall proceed to close up such association." 12 U.S.C. § 191 (1970).

The FDIC acts in several capacities when a national bank is declared insolvent by the Comptroller. First—and this is its best known function—it pays depositors whose accounts it has insured, either directly or by making available a transferred deposit in another insured bank. Second, the statute provides that when the Comptroller appoints a receiver for a national bank, he shall appoint the FDIC, 12 U.S.C. § 1821(c), (f) (1970).

After the Comptroller is satisfied that a national bank is insolvent and appoints the FDIC as receiver, the FDIC

"upon the order of a court of record of competent jurisdiction . . . may sell all the real and personal property of such association on such terms as the court shall direct." 12 U.S.C. § 192 (1970).

The Authority of Federal Reserve Banks to Make Collateralized Advances to Member Banks

While a national banking system was first established during the Civil War, the Federal Reserve System dates from the reforms of 1913. Act of December 23, 1913, ch. 6, 38 Stat. 251. The report of the House Committee recommending passage of the bill which became the Federal Reserve Act, H.R. Rep. No. 69, 63rd Cong., 1st Sess. (1913), discussed the "longstanding evils" and "essential defects" in the national banking system which the bill was intended to correct, *Id.* at 3, including:

> (a) "[T]he country has lacked the capacity either to prevent credit disorders from breaking out locally and spreading to the centers, or to defend its own resources against the monetary demands of foreign nations or against the infection due to bad financial conditions in countries with which we stood in close relations." (*Id.* at 4)
>
> (b) "In 1873, 1884, 1890, 1893, 1896 and 1907, to mention the most familiar occasions, it has been necessary for large groups of banks practically to suspend specie payments. . . . In spite of all that could be done, however, the public has been put to great inconvenience and loss upon such occasions, the relations of the United States with foreign countries have been embarrassed, if not brought into jeopardy, the failure of firms, corporations, and individuals has been necessitated, and the loss of wealth has been tremendous." *(Id.)*

(c) "[T]he national banking system . . . fails to afford any safeguard against panics and commercial stringencies or any means of alleviating them." (H.R. Rep. No. 69 at 6)

To solve these problems, the report went on to specify the fundamental objects of the proposed legislation, which included:

"General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past." (*Id.* at 11)

Since then, further refinements in the system have been made, particularly in response to the crash of 1929 and its aftermath. We focus herein on the power of Federal Reserve Banks to make advances to member banks.

12 U.S.C. § *347*—The first limited grant of authority for advances by Federal Reserve Banks to member banks on the members' notes was given in Section 13 of the Federal Reserve Act amendments of 1916, Act of September 7, 1916, ch. 461, 39 Stat. 752.

This provision was substantially reformulated by Section 9 of the Banking Act of 1933. Act of June 16, 1933, ch. 89, § 9, 48 Stat. 180. *See* S. Rep. No. 77, 73d Cong., 1st Sess. 14 (1933); H.R. Rep. No. 150, 73d Cong., 1st Sess. 2 (1933). Apart from several amendments with respect to the types of collateral required as security for the notes of member banks, the provision exists today in substantially the same form in 12 U.S.C. § 347 (1970). It sets forth in technical detail the types of security which a member bank must pledge to secure advances from a Reserve

Bank pursuant to its provisions. (*E.g.,* Treasury bills, debentures of some Federal credit banks, notes eligible for rediscount).

12 U.S.C. § *347b*—In response to the banking emergency that followed the crash of 1929, Congress passed emergency legislation adding Section 10(b) to the Federal Reserve Act, which provided for additional temporary advances to member banks on a less restricted basis than Section 13. Act of February 27, 1932, ch. 58, §§ 1-2, 47 Stat. 56. This temporary authority was extended and expanded several times; for example, in 1933, the restriction on the size of member banks to which such advances could be made was eliminated (Act of March 9, 1933, ch. 1, § 402, 48 Stat. 7). Most of the remaining restrictions were eliminated when Congress finally made Section 10(b) a permanent provision of the Federal Reserve Act.

In 1935 Congress granted permanent authority for such advances and amended Section 10(b) of the Federal Reserve Act to read as follows:

"Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Each such note shall bear interest at a rate not less than one-half of 1 per centum per annum higher than the highest discount rate in effect at such Federal Reserve Bank on the date of such note." Act of August 23, 1935, ch. 614, § 204, 49 Stat. 705.

The House report on § 206 of the original House bill, H.R. Rep. No. 742, 74th Cong., 1st Sess. (1935), discussed the reasons for the amendment of Section 10(b):

"Existing limitations had to be suspended during the emergency, but this was accomplished only after they had done a great deal of harm and after many banks had failed because of a lack of assets technically eligible for obtaining accommodation at a Federal Reserve bank. Since in practice existing restrictions must be relaxed whenever they become really restrictive, it is best not to have them in the law, but to place full regulatory responsibility on the Board, which is always in session and in a position to take prompt action when it is required.

* * *

"This amendment, by removing many of the technical restrictions of the present law, will enable the Federal Reserve banks to render better service to their member banks in times of need. This will not only make membership in the Federal Reserve System much more attractive but will encourage the member banks to invest their savings deposits, which are essentially capital funds, in longer-term loans, a course that would greatly facilitate business recovery.

"This amendment will also make it possible for banks, without relaxing prudence or care, to meet local needs both for short-time and for long-time funds, and to be assured that in case of need they can obtain advances from the Reserve banks on the basis of all their sound assets, regardless of their form or of the nature of their collateral." (at 10-11)

Pursuant to these provisions, and the power given the Federal Reserve Board to issue regulations by Section 4(8) of the Act, 12 U.S.C. § 301, the Board promulgated Regulation A which provided *inter alia:*

"(c) *Short-term adjustment credit.* Federal Reserve credit is available on a short-term basis to a member bank, under such rules as may be prescribed, to such extent as may be appropriate to assist such bank in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of the bank's assets and liabilities." 12 C.F.R. § 201.2(c) (1977)

* * *

"(e) *Emergency credit for member banks.* Federal Reserve credit is available to assist member banks in unusual or emergency circumstances such as may result from national, regional, or local difficulties or from exceptional circumstances involving only a particular member bank." 38 Fed. Reg. 9,076 (1973)*

* The amendment of subparagraph (e) of Regulation A by the Federal Reserve Board, effective September 25, 1974, further clarified the meaning of "exceptional circumstances" involving a particular bank:

"(e) *Other credit to member banks.* (1) In the event of unusual or emergency circumstances resulting from national, regional, or local difficulties, Federal Reserve credit beyond that contemplated under paragraph (c) of this section is available.

"(2) Federal Reserve credit is also available for protracted assistance where there are exceptional circumstances or practices involving only a particular member bank. A special rate apart from rates charged for lending to member banks under other provisions of this Part may be established by Federal Reserve Banks subject to review and determination by the Board of Governors and applied to such credit. The special rate may apply to member banks borrowing for prolonged periods (such as for more than eight weeks) and in significant amounts (such as when the loan has exceeded on average the amount of the borrowing bank's required reserves) because of financial strains arising from particular circumstances or practices affecting the individual bank—including sustained deposit drains, impaired access to money market funds, or sudden deterioration in loan repayment performance. In no case should the special loan rate to member banks exceed the rate established for loans to nonmembers under 12 U.S.C. 347(c)." 12 C.F.R. § 201.2(e) (1977)

The Franklin National Bank Crisis

By mid-May 1974, it was public knowledge that Franklin National had suffered large losses due to certain foreign exchange transactions and was in a precarious financial position. On Sunday, May 12, 1974, George W. Mitchell, Vice Chairman of the Federal Reserve Board, announced that the Federal Reserve System stood ready to advance funds to the Franklin National and that:

> "As a matter of general policy the Federal Reserve makes credit extensions to member banks, upon acceptable collateral, so long as the borrowing member bank is solvent. We are assured by the Comptroller of the Currency that Franklin National Bank is a solvent institution." (Pet. p. A41-42)*

A letter from the Acting Comptroller of the Currency to the Federal Reserve Board, dated May 10, 1974, stated:

> "At the last full examination of the subject bank which terminated on March 8, 1974, the bank was found to have fairly severe credit and liquidity problems, but was adjudged to be solvent. Although the liquidity problem has subsequently become aggravated by adverse rumors circulating in the market place, to date, we have not received any information which would materially alter our March 8, 1974 conclusion that the bank is solvent. If there is any significant change in the condition of the bank, this Office will promptly advise you." (Pet. p. A41)

That Franklin National faced severe liquidity problems which in the circumstances made it appropriate in the Reserve Bank's judgment for it to lend, on a collateralized basis as mandated by statute, massive amounts to Franklin National was hardly a secret. By May 31, 1974, it was public knowledge that Franklin National's borrowings from the Reserve Bank had risen to over one billion dollars.

* This announcement was preceded by disclosures during the week which on May 13, 1974 led the Securities and Exchange Commission to suspend trading in the stock of Franklin National's parent holding company. 39 Fed. Reg. 18,166 (1974)

Throughout the summer of 1974 there were various efforts, widely known, to find a solution to the liquidity problem of Franklin National and permit repayment of the Reserve Bank's loans whether by merger of Franklin National with another bank or otherwise.

By the fall, the search for a merger partner had failed, and the only viable alternative solution was a sale of Franklin National's assets to another bank which would also assume its deposit liabilities. On October 8, 1974, the Comptroller declared, pursuant to 12 U.S.C. § 191 (1970), that he had become satisfied that Franklin National was insolvent, and he appointed the FDIC as receiver for the Franklin National. The receiver issued a call for bids for the purchase of Franklin National's assets (pursuant to previously drafted documents) and determined that the bid by the European American was the best bid submitted.

Immediately thereafter, the district court, pursuant to 12 U.S.C. § 192 (1970), approved the receiver's sale of most of the assets, finding that it appeared to be the "best solution to a serious and delicate problem." *In re Franklin National Bank,* 381 F.Supp. 1390, at 1393 (E.D.N.Y. 1974). The following morning Franklin National's doors were open, but under the name of the new owner of its banking business.

The Complaint

Huntington's complaint, filed April 23, 1975, made two claims. The first was that the Comptroller's failure to declare Franklin National insolvent and the Reserve Bank's

massive assistance to it constituted a fraudulent representation as to the bank's condition, although the extent of the collateralized assistance and the troubled condition of the bank were publicly announced at the time. The second claim was that the Reserve Bank's required taking of collateral for the new monies it advanced to the Franklin National constituted a "preference". (Pet. p. A13)

The complaint alleged, on information and belief, that Franklin National was insolvent on or about May 1, 1974 and that on or about May 15, 1974 the defendants (including the Reserve Bank) knew the bank was insolvent and that it "should" have been declared insolvent. The defendants, so the claim alleged, entered into a "scheme" to conceal the purported insolvency and as part of the "scheme" the Reserve Bank made collateralized advances to Franklin National. (Pet. p. A5)

Huntington is a real estate developer which had borrowed construction funds from Franklin National and in June of 1974 allegedly gave additional security to Franklin National pursuant to its agreement with the bank. In September 1974, it was alleged, that due to Franklin National's financial condition, the bank was no longer able to advance further funds for the construction with the result that Huntington's construction came to a halt. Damages of $8,000,000 were claimed, without explanation. (Pet. p. A4-A5)

In the second claim, Huntington claimed to be "general creditors" of Franklin National, presumably on the theory that Franklin National allegedly owed Huntington $8,000,000 by reason of the first claim. Huntington alleged, again on information and belief, that the sale of assets and other arrangements approved by the district court pursuant to 12 U.S.C. § 192 (1970) "are contrary to law and constitute a fraud on the general creditors of Franklin

National." (Pet. p. A27) The complaint sought a declaration that the Reserve Bank "is not entitled to any security interest or preference" as against the plaintiffs and an injunction against the FDIC recognizing any such security interest. (Pet. p. A27)

The final item of the prayer for relief of the complaint demanded that the court declare null and void all mortgages and notes given to Franklin by Huntington, thus eliminating all evidence of and security for Huntington's debt to Franklin National.

The Decision of the District Court

The district court, *per* the late Orrin J. Judd, D.J., held that the Comptroller's determination that he was, in the express terms of 12 U.S.C. § 191, "satisfied" that Franklin National was solvent is unreviewable, and that his decision cannot be collaterally challenged by way of a claim against the Reserve Bank.

As to Huntington's assertion that the Reserve Bank "should" not have made advances to Franklin, the court held that such discretionary determinations are also not reviewable. The court found that if such decisions were to be subjected to scrutiny by courts after the fact, the ability of Federal Reserve Banks to react swiftly pursuant to their statutory authority to deal with bank liquidity crises would be unacceptably inhibited.*

* While the district court also based its dismissal of Huntington's "tort" claim on the Federal Tort Claims Act, 28 U.S.C. § 2680(h) (Supp. V 1975), there was no need to do so, since the discretionary action of the Reserve Bank involved here is not justiciable whether or not the jurisdictional limitations of the Federal Tort Claims Act apply to Federal Reserve Banks. The court of appeals affirmed the district court's dismissal of the complaint, but on the ground that subject matter jurisdiction was lacking.

Huntington's claim that the secured advances made by the Reserve Bank constituted a "preference" was also found to be without merit, since 12 U.S.C. § 347b specifically authorizes such loans and requires that they be collateralized. The court found that an essential purpose of the Federal Reserve Act was to give Federal Reserve Banks the authority to act as lenders of last resort to member banks and to respond to problems affecting the banking system as a whole. The court also relied on the principle that a pledge of collateral for new money (as opposed to an antecedent debt) is not a preference. Finally, the court found that, in any case, the Reserve Bank was not needed as a party to the action since its lien had been released for the benefit of European American Bank and the FDIC.

The Decision of the Court of Appeals

As did the district court, the court of appeals recognized that the actions of the Reserve Bank attacked by Huntington served to minimize the effects of a liquidity crisis and a resulting premature insolvency and the incalculable effects on the banking system and the national economy. The court held that subject matter jurisdiction was lacking for Huntington's claim of tort and affirmed the district court's decision that both the fixing of the date of insolvency by the Comptroller and the making of collateralized advances by the Reserve Bank were exercises of judgment within their competence and authority. Referring to the regulations concerning advances and the legislative history, the court of appeals held that the Reserve Bank, in making the advances, was doing precisely what Congress intended it to do in such situations. The court held that, absent clear evidence of grossly arbitrary or capricious action on the part of the Comptroller or the

Reserve Bank, an attack upon their performance of functions essential to the stability of the nation's banking system is not justiciable.

As to Huntington's second claim that the Reserve Bank, in taking collateral as security for the advances it made (as required by 12 U.S.C. § 347(b)), received a "preference", the court found that the Reserve Bank was not a necessary party to the claim because it had released its lien on the collateral and that if Huntington's claims were meritorious, the proper party affected would be the FDIC, not the Reserve Bank. The court ruled that Huntington Towers could continue its claim for "rescission" against FDIC, as receiver, and if it established a right to excess collateral over the debt pledged, it could assert its claim for legal or equitable relief against European American Bank as assignee, but until then such a claim would be premature.

REASONS FOR DENYING THE WRIT

I.

No Sufficient Ground for the Grant of a Writ of Certiorari Has Been Stated.

Both of the asserted grounds for granting the writ are based on non-existent conflicts.

—Huntington claims that the decision below conflicts with *Economou* v. *United States Department of Agriculture,* 535 F.2d 688 (2d Cir. 1976), *cert. granted sub nom. Butz* v. *Economou*, 429 U.S. 1089 (1977). *Economou* dealt only with the extent (absolute or qualified) of immunity of federal officials from personal liability for damage suits based on their partic-

ipation in the institution or prosecution of administrative enforcement proceedings. The court below stated that it perceived no conflict between that decision and its decision here, and there is none. (Pet. p. A15 n.2)

—Huntington also asserts that the decision below conflicts with the congressional policy in favor of ratable distributions. There is no conflict between the recognition of the superior rights of lien holders and the requirement that what remains after such recognition be distributed ratably.

II.

The Courts Below Correctly Decided That the Making of Collateralized Advances by a Federal Reserve Bank Does Not Present a Justiciable Claim.

The court of appeals found that in making collateralized advances to Franklin National, which had not been determined to be insolvent by the Comptroller, the Reserve Bank was discharging a judgmental governmental function for the precise purpose that the function was intended—to meet liquidity crises involving national banks—and that the propriety of the making of these advances was not subject to later attack in an action such as this.*

The pertinent statutes and regulations fully support that decision. Sections 10 and 13 of the Federal Reserve Act, 12 U.S.C. § 347b (Supp. V 1975) and 12 U.S.C. § 347 (1970) and Regulation A precisely authorized Federal Reserve Banks to make collateralized advances to national banks in accordance with their best judgment regarding the pres-

* The cases cited by the court of appeals and discussed herein as well as the legislative history of the national banking acts demonstrate that such decisions are governmental functions. *See Federal Reserve Bank* v. *Commissioner of Corporations and Taxation*, 499 F.2d 60, 62-64 (1st Cir. 1974).

ence or absence of emergency or exceptional circumstances and the acceptability of the available collateral. The issue therefore, if properly presented, is not whether the "bank regulators" are "absolutely immune", as Huntington would frame it, but whether a statutory scheme, couched, as it necessarily is, in permissive terms that advances "may" be made and that the Comptroller acts when he is "satisfied" as to insolvency, provides a private cause of action or permits judicial review of decisions made pursuant to the pertinent legislation.*

Many factors are involved in the decision to advance money to a troubled national bank and they can only be evaluated by officers of Federal Reserve Banks in light of their expertise acquired through experience in this specialized area of banking and their intimate knowledge of the state of the economy and the national bank in question. The decision, as was true in the case of Franklin National, must often be made immediately if the bank's doors are to remain open and panic is to be avoided.

It would invite financial chaos for the courts to intrude after the fact upon the determination of the Comptroller of whether or not a national bank is insolvent or the deci-

* The only basis alleged in the complaint for Huntington's "fraud" claim was the Comptroller's failure to declare the Franklin National insolvent in May, 1974 and the advances made by the Reserve Bank when it "knew" the bank "should" have been declared insolvent. Nothing which might permit an inference of some independent fraud was asserted. As the court found in *Davis* v. *Federal Deposit Insurance Corp.*, 369 F. Supp. 277, 280 (D. Colo. 1974) the respondents were under no duty to disclose to the plaintiff what they "knew" about the financial condition of the bank and indeed what was publicly known. This distinguishes the sole case relied upon by Huntington as authority that it had stated a cause of action for fraud. *Cassidy* v. *Uhlmann*, 27 App. Div. 80, 50 N.Y.S. 318 (1st Dep't 1898), *rev'd on other grounds,* 163 N.Y. 380, 57 N.E. 620 (1900) (Pet. p. 21) involved the fiduciary duty of bank directors to disclose to depositors their knowledge of the insolvency of the bank.

sion of a Federal Reserve Bank to advance funds to solve a liquidity crisis and thus to keep a national bank from closing its doors prior to a determination of insolvency by the Comptroller. The existence and viability of financial institutions depend, in a most crucial manner, upon continued public confidence. When the public loses confidence in a bank, depositors will cause a run on the bank, preventing it from honoring checks drawn on its accounts, and thus threatening public confidence in other banks. The federal regulatory scheme is designed to reduce the risk of such public panics—the Federal Reserve Banks act as lenders of last resort to assist banks with problems of maintaining liquidity, the FDIC insures deposits and the Comptroller decides when a bank has reached the point where there is no alternative but a receiver. This complex mechanism cannot function if the decisions of the banking authorities to act or not to act are subject to later attack in private litigation, and in particular, if the courts undertake to decide whether and when the Comptroller should be "satisfied" that a national bank is insolvent, or whether or when a Reserve Bank may lend funds to a troubled national bank.

This was one of the points of this Court's decision in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), *per* Mr. Justice Marshall, which held that the customers of a brokerage firm could not sue to compel the Securities Investor Protection Corporation ("SIPC") to grant its protection to the brokerage firm. The Court noted the special expertise and range of alternatives employed by SIPC, which generally delays seeking a receiver until there are no realistic alternatives.

> "By this policy, the SIPC avoids unnecessarily engendering the costs of precipitate liquidations—the costs not only of administering the liquidation, but also of customer illiquidity and additional loss of confidence in the capital markets—without sacrifice of any customer protection that may ultimately prove necessary. A customer, by contrast, cannot be expected to consider, or have adequate information to consider, these public interests in timing his decision to apply to the courts.
>
> "The respondent in this case does not, of course, claim any right to make the decision that a firm should be liquidated; the Act makes that a judicial decision. He seeks only the right to ask the District Court to make that decision when both SIPC and the SEC have refused or simply failed to do so. In practical effect, however, the difference is slight. Except with respect to the solidest of houses, the mere filing of an action predicated upon allegations of financial insecurity might often prove fatal. Other customers could not be expected to leave their cash and securities on deposit, nor other brokers to initiate new transactions that the firm might not be able to cover when due if a receiver is appointed, nor would suppliers be likely to continue dealing with such a firm. These consequences are too grave, and when unnecessary, too inimical to the purposes of the Act, for the Court to impute to Congress an intent to grant to every member of the investing public control over their occurrence. On the contrary, they seem to be the very sorts of considerations that motivated Congress to put SIPC in the hands of a public board of directors, responsible to an agency experienced in regulation of the securities markets." (Footnotes omitted) 421 U.S. at 422-23.

The authority vested in Federal Reserve Banks by Congress carries none of the requisite indicia of reviewability or actionability. This Court would have no statutory or

constitutional standard by which to judge the decisions that advances "should" or should not be made or that the Comptroller "should" have been "satisfied" as to insolvency sooner than he was. *Cf. Hadden* v. *Merritt,* 115 U.S. 25, 27-28 (1885); *Coleman* v. *Miller,* 307 U.S. 433, 453-56 (1939).* Sensitive judgment calls grounded on sophisticated economic expertise are not within the competence of the judiciary, as this Court has said. *Cf. Chicago & Southern Air Lines Inc.* v. *Waterman Steamship Corp.,* 333 U.S. 103, 111 (1948). The legislative history of the national banking acts evidences no congressional intention to vest in private persons a federal right to damages for a purported failure to act pursuant to the statute. *Cf. Securities Investor Protection Corp.* v. *Barbour, supra; Cort* v. *Ash,* 422 U.S. 66, 82-83 (1975) and *see, Inland Waterways Corp.* v. *Young,* 309 U.S. 517, 523-24 (1940).

The decision of a Federal Reserve Bank to advance funds against required collateral to a national bank suffering from a liquidity crisis is political in the same sense as a Congressional decision to lend Federal monies to a municipal or private corporation. One might argue—as a

* The authorities are unanimous that only the Comptroller may determine whether he is "satisfied" that a national bank is solvent, and that the courts cannot substitute their determinations for that of the Comptroller. *Easton* v. *Iowa,* 188 U.S. 220 (1903); *Casey* v. *Galli,* 94 U.S. 673 (1876); *Kennedy* v. *Gibson,* 75 U.S. (8 Wall.) 498 (1869); *United States Savings Bank* v. *Morgenthau,* 85 F.2d 811 (D.C. Cir)., *cert. denied,* 299 U.S. 605 (1936); *B.V. Emery & Co.* v. *Wilkinson,* 72 F.2d 10 (10th Cir. 1934); *Liberty Nat'l Bank* v. *McIntosh,* 16 F.2d 906 (4th Cir.) *cert. dism'd,* 273 U.S. 783 (1927); *Deweese* v. *Smith,* 106 F. 438 (8th Cir. 1901), *aff'd w/o opinion sub nom. Smith* v. *Brown,* 187 U.S. 637 (1902); *In re American City Bank & Trust Co.,* 402 F. Supp. 1229 (E.D. Wis. 1975); *United States Nat'l Bank* v. *Pole,* 2 F. Supp. 153 (D. Ore. 1932); *O'Connor* v. *Bankers Trust Co.,* 159 Misc. 920, 289 N.Y.S. 252 (Sup. Ct. N.Y. Co. 1936), *aff'd* 253 App. Div. 714, 1 N.Y.S.2d 641 (1st Dep't 1937), *aff'd,* 278 N.Y. 649, 16 N.E.2d 302 (1938); *cf. In re Conservatorship of Wellsville Nat'l Bank,* 407 F.2d 223 (3d Cir.), *cert. denied,* 396 U.S. 832 (1969).

political matter—over whether such loans were good or bad economic policy, but it would not be thought that they give rise to a claim by a private party that "fraud" or any other legally cognizable wrong had been committed.

Other courts have recognized that such policy considerations, in the precise context of the national banking scheme, preclude them from intruding on such delicate areas as are at issue here. In *Billings Utility Co.* v. *Advisory Committee,* 135 F. 2d 108 (8th Cir. 1943), a Federal Reserve Bank refused to make a loan under 12 U.S.C. § 352a, a section (later repealed) providing for working capital loans to businesses under "exceptional circumstances." The plaintiffs alleged that the refusal was "wilful, arbitrary, capricious," etc. and requested damages. The Court of Appeals for the Eighth Circuit affirmed a judgment for the Federal Reserve Bank, holding that its freedom to act upon any application for credit must be protected and such exercise of its discretionary authority is not reviewable. To the same effect, see *Raichle* v. *Federal Reserve Bank,* 34 F.2d 910 (2d Cir. 1929); *Bryan* v. *Federal Open Market Committee,* 235 F. Supp. 877 (D. Mont. 1964); and *Greene County National Farm Loan Ass'n* v. *Federal Land Bank,* 152 F.2d 215 (6th Cir. 1945).*

The comment by the court in *Fahey* v. *O'Melveny & Myers,* 200 F.2d 420, 472-73 (9th Cir. 1952) concerning the Federal Home Loan Bank System is pertinent:

> ". . . the 'determination' was a decision of a kind with which the judiciary should not be concerned, for courts have neither the aptitude nor the facilities to weigh the need for such orders which in our view belong in

* These decisions are but applications of the more general principle that, as stated by Chief Justice Marshall in *Marbury* v. *Madison,* 5 U.S. (1 Cranch) 137, 170 (1803): "Questions in their nature political, or which are, by the constitution and laws, submitted to the executive, can never be made in this court."

the domain of political power and are therefore not subject to judicial intrusion or inquiry. Decisions upon which such orders rested are delicate and complex, and necessarily involve large elements of prophecy and to that extent are akin to the decisions discussed in Chicago & Southern Air Lines, Inc. v. Waterman S.S. Corporation, 333 U.S. 103, ...

"We have to confront the fact that Congress created its own administrative agency to weigh all phases of the complex problems arising in the operation of the Home Loan Bank System and vested it with authority to use its discretion in ultimately determining in some formal manner the most suitable and desirable solution for specific problems one of which might be a readjustment of bank districts."

In sum, Huntington's dispute is not with the Reserve Bank, with the Comptroller, with the FDIC or, for that matter, with any "scheme" among them, but rather with the legislation governing national banks. Their recourse, if any, lies in the legislative and not the judicial process.

III.

There Is No Conflict Between Recognition of the Reserve Bank's Security Interest and the Policy of Ratable Distributions to Unsecured Creditors.

On October 8, 1974 the Reserve Bank released and agreed to release its lien upon collateral which might have included collateral pledged to Franklin National by Huntington. Huntington's argument in this regard therefore proceeds from the false premise that the Reserve Bank by virtue of its lien is a necessary party. The court below correctly held that the Reserve Bank is not.

But accepting *arguendo* the Huntington premise, once the Reserve Bank determined to exercise its discretionary authority to advance funds to Franklin National, it was required to obtain collateral satisfactory to it for such advances. Various statutes requiring that bodies clothed with a governmental purpose obtain security for their funds are the result of a strong national policy which is embodied in, but also predates the national banking acts. *Inland Waterways Corp.* v. *Young,* 309 U.S. 517 (1940). To void the lien of the Reserve Bank as an unlawful preference would both ignore the clear statutory mandate and as surely abrogate the Federal Reserve Banks' ability to make the advances as would a holding that the advances themselves were tortious.

The only federal statute under which the giving of a pledge or security for a loan to a national bank may be avoided is 12 U.S.C. § 91 (1970). *Schumacher* v. *Eastern Bank & Trust Co.,* 52 F.2d 925, 928 (4th Cir. 1931). The law is clear, and it has been for many years, that Section 91 can have no application to the situation presented here because the Reserve Bank received security interests only for "new money" it loaned Franklin National. 7 A. Michie, *Banks and Banking* § 239 at 458-59 (Cum. Supp. 1971). A preference, on the other hand, is created when a creditor receives security in respect of an antecedent debt in contemplation of a debtor's insolvency. *Armstrong* v. *Chemical National Bank,* 41 F. 234 (C.C.S.D.N.Y. 1890); *Lucas* v. *Federal Reserve Bank,* 59 F.2d 617 (4th Cir. 1932). To void security taken to secure a new loan would be to prefer the other antecedent creditors who would thus be benefitted by the loan while forcing the new lender to give up the security which induced him to extend the loan. *Stapylton* v. *Stockton,* 91 F. 326 (5th Cir. 1899).

Moreover, the prohibitions of Section 91 apply only when the collateral is received "after the commission of an act of insolvency or in contemplation thereof." The secured interest here did not come into being after "the commission of an act of insolvency." Nor can it be said that advances were made "in contemplation" of insolvency. Huntington itself asserts that "until it was declared insolvent, Franklin National continued to conduct business and deal with customers . . ." and Franklin National "continued to advance funds from time to time for the construction of [Huntington's] building until October 8, 1974. . . ." (Pet. p. 4). Because there was always the hope that the bank might survive and because it continued to conduct its business until the Comptroller's declaration, the Reserve Bank's assistance was not, as a matter of law, "in contemplation" of insolvency. *McDonald* v. *Chemical National Bank,* 174 U.S. 610, 618 (1899).*

This Court held in *Wyman* v. *Wallace,* 201 U.S. 230 (1906) that secured notes issued by a national bank which was unable to pay maturing deposits were valid, despite the argument that the predecessor of Section 91 precluded such a transaction.

> "The question, therefore, is, whether a national bank, finding itself embarrassed, with a large amount of

* In this respect, the giving of security for loans to a national bank is different from the securing of private deposits, which was the situation in *Roberts* v. *Hill,* 24 F. 571 (C.C.D.Vt. 1885) (Pet. p. 20) and *Texas & Pacific Ry.* v. *Pottorff,* 291 U.S. 245 (1934). In *Hirning* v. *Federal Reserve Bank,* 52 F.2d 382 (8th Cir. 1931) and *Vann* v. *Federal Reserve Bank,* 47 F.2d 786 (E.D.Va. 1929), also cited by Huntington (Pet. p. 20) a Federal Reserve Bank was merely acting as a collection agent after the drawee bank suspended operations; in neither case was security taken for new money, nor was the Federal Reserve Bank acting pursuant to statutory authority in its extraordinary capacity as a lender of last resort to member banks.

> assets, much in excess of its obligations, yet without the cash to make payment of those which are due and urgent, can borrow to meet those pressing demands. A very natural answer is, why not? It is not borrowing money to engage in a new business. It simply exchanges one creditor for others. There may be wisdom in consolidating all its debts into the hands of one person. At least such a consolidation cannot be pronounced beyond its powers. When time is obtained by the new indebtedness (in this case a year) it gives the borrowing bank and its officers and stockholders time to consider and determine the wisdom of attempting a further prosecution of business. In the case of an individual it would be a legitimate and often a wise transaction. It is not in terms prohibited by the national banking act." (201 U.S. at 243)

Other cases which recognize that it is entirely proper, and indeed desirable, for one bank to lend assistance to another bank in fianancial difficulties are *Harris* v. *Briggs,* 264 F. 726 (8th Cir. 1920); *Nakdimen* v. *First National Bank,* 177 Ark. 303, 6 S.W.2d 505 (1928); *Candor* v. *Mercer County State Bank,* 257 Ill. App. 192 (1930).

Huntington's real complaint is that a secured party may keep, or bargain away, his collateral in the event of default—as Congress intended when it required Federal Reserve Banks to make advances only against collateral. The right of a secured party has long been held not to conflict with the National Banking Act's requirement of ratable distribution to general creditors. *Ticonic National Bank* v. *Sprague,* 303 U.S. 406, 412 (1938). *Cf. American Surety Co.* v. *Bethlehem National Bank,* 314 U.S. 314, 317-19 (1941).

CONCLUSION

The petition presents no sufficient ground for review by this Court of the decision below. Rather, it presents an unsound argument to the Congress concerning the national banking legislation. The petition should be denied.

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IN THE

Supreme Court of the United States

October Term, 1977

HUNTINGTON TOWERS, LTD. and
RICHARD CAREY,

Petitioners,

v.

FEDERAL RESERVE BANK OF NEW YORK, EUROPEAN-AMERICAN BANK and JAMES SMITH, individually and as Comptroller of the Currency,

Respondents.

77-564

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

EUROPEAN-AMERICAN'S BRIEF IN OPPOSITION TO THE PETITION FOR CERTIORARI

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EUROPEAN-AMERICAN'S BRIEF IN OPPOSITION TO THE PETITION FOR CERTIORARI

The only issue concerning Respondent European-American Bank & Trust Company ("European-American") raised by the petition for certiorari is whether plaintiffs, petitioners here, can avoid the New York statute of frauds, N.Y. GEN. OBLIG. LAW § 5-703(1) (McKinney 1964), in their effort to create an enforceable financing contract out of certain alleged oral representations ("Questions Presented" Nos. 5 and 6). The other issues raised by the petition, which relate to the insolvency of Franklin National Bank, do not involve European-American.

Plaintiffs ask the Court to make a factual determination that there was "part performance" sufficient to take the case out of the statute of frauds. That is not the function of the Court's discretionary jurisdiction. *See United States* v. *Johnston*, 268 U.S. 220, 227 (1925): "We do not

grant . . . certiorari to review evidence and discuss specific facts."

Moreover, as noted by both courts below (A18, A47), plaintiffs do not even allege part performance or reliance to their detriment. Instead, they invert the doctrine and allege that European-American partly performed to *its* detriment. As also noted by the court of appeals (A18 n.3), the facts alleged by plaintiffs do not amount to an agreement, oral or otherwise, that could be enforced by a court.

In sum, the question of "part performance" is governed by application of state law to the particular (and peculiar) facts, and the applicable state law could not more clearly preclude the claim. Thus, review on certiorari is wholly unjustified. *See Huddleston* v. *Dwyer,* 322 U.S. 223, 237 (1944):

> "[O]rdinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts."

As they did below, plaintiffs seek also to have the Court declare that the state statute of frauds is pre-empted by a provision in a federal statute governing the loan portfolios of national banks. 12 U.S.C. § 371 (1974). European-American, however, is not a national banking association and is not subject to the provision plaintiffs cite. Moreover, that provision relates only to the amount of credit national banks may extend in connection with real estate transactions and, as noted by the court of appeals (A17-18), has no bearing on whether a writing is required for creation of an enforceable contract.

Conclusion

For the reasons stated, the petition for certiorari should be denied insofar as it seeks review of the court of appeals' application of the statute of frauds.

Respectfully submitted,

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